

THE STATE OF THE
INTERNATIONAL FINANCIAL SYSTEM

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COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
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ROBERT U. FOSTER, III, *Staff Director*

C O N T E N T S

	Page
Hearing held on:	
April 19, 2005	1
Appendix:	
April 19, 2005	39

WITNESS

TUESDAY, APRIL 19, 2005

Snow, Hon. John W., Secretary, United States Department of the Treasury	7
--	---

APPENDIX

Prepared statements:

Oxley, Hon. Michael G.	40
Pryce, Hon. Deborah	42
Waters, Hon. Maxine	44
Snow, Hon. John W.	46

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Waters, Hon. Maxine:

Written questions to Hon. John W. Snow	56
--	----

Snow, Hon. John W.:

Written response to questions from Hon. Michael G. Oxley	60
Written response to questions from Hon. Brad Sherman	59
Written response to questions from Hon. Maxine Waters	58

THE STATE OF THE INTERNATIONAL FINANCIAL SYSTEM

Tuesday, April 19, 2005

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The Committee met, pursuant to call, at 3:02 p.m., in Room 2128, Rayburn House Office Building, Hon. Michael G. Oxley [chairman of the Committee] Presiding.

Present: Representatives Oxley, Pryce of Ohio, Royce, Paul, Manzullo, Biggert, Hensarling, Pearce, Davis of Kentucky, McHenry, Frank, Waters, Sanders, Maloney, Watt, Baca, Scott, Davis of Alabama, Green, Cleaver, and Moore of Wisconsin.

The CHAIRMAN. The Committee will come to order.

Mr. Secretary, it is good to have you back again this afternoon and welcome back to the Committee.

We are glad to have you here for the Financial Services Committee for another annual testimony on the state of the international financial system. We meet as the group of seven countries strive to make structural changes identified in the Agenda for Growth. Global imbalances are global challenges that all parties need to meet in order to safeguard continued economic growth around the world. At the same time, G-7 leaders are considering how best to fund development and manage the IMF's assets.

U.S. leadership in the G-7 has generated innovative approaches for addressing the challenges and opportunities presented by China's growth. I hope that real progress on these issues can be made in time for the G-7 summit later this summer.

I note that this is the Secretary's first testimony since Congress passed and the President signed the Intelligence Reform and Terrorism Prevention Act. That Act included a requirement authored by my colleague, Mrs. Biggert, that this annual testimony include an assessment of international cooperation and coordination from the IMF, World Bank and other multilateral policymaking bodies in the fight against terrorist finance. I look forward to your testimony on this topic.

Economic resilience and continued growth are critical components to providing peace, stability and freedom around the world. As President Bush has noted, economic and political freedom gives hope to millions who are weary of poverty and oppression.

As your testimony rightly points out, a 5 percent expansion in sub-Saharan economies over the next 2 years would lift nearly 30 million people out of poverty. One important method for promoting economic development is to foster conditions for more balanced

growth worldwide. Stronger economies create more demand, promote economic opportunity and ownership and provide a foundation for political stability. I look forward to hearing your ideas for how we could support European efforts to make the necessary labor and other structural reforms that are so needed.

I continue to support the President's efforts to express America's compassion for the world's most vulnerable people through a wide range of development initiatives. I also support the increase by \$100 million for multilateral development assistance for the International Development Association and the African Development Fund and the increased proportion of grants.

The UK's presidency of the G-7 is wisely spent focusing on development issues. I commend our cousins across the Atlantic for their vision, even as I question whether all the proposals make sense. I will be interested to hear your views on the proposed International Financing Facility. I expect we will evaluate the IDA and ADF replenishment requests in light of progress made to implement performance-based assessments as well as efforts to increase transparency anti-corruption programs and accountability.

We need to make sure that development dollars are allocated efficiently and are going to the people who need it most. I hope the new president of the World Bank will adopt as a high personal priority continuation and expansion of the bank's anti-corruption efforts.

This could help counterbalance potential bureaucratic backsliding and competitive pressures among other regional MDBs to lower standards. Regarding proposals to mobilize some of the IMF's gold reserves to fund debt relief, I note that U.S. negotiation to sell IMF gold cannot be conducted without Congressional authorization starting with this Committee. We have not received such a request, and I understand there is no consensus, at least at this time, in favor of gold sales within the G-7. Therefore, I assume that no such negotiations are underway.

In the area of trade liberalization, at all levels can be more effective than development assistance in fostering economic growth. Trade is not a zero sum game, and all participants benefit from liberalization. I look with cautious optimism at the broader Doha round of negotiation in the WTO, as well as efforts within the group of 20 to support progress on the global trade agenda.

I would urge you, Mr. Secretary, to be actively and personally engaged to move along the financial services negotiations.

Last, but certainly not least, I focus on Europe and the Financial Markets Dialogue. We meet as the U.S. and the EU for forging a reinvigorated relationship following the President's successful visit to Europe last month. The Treasury Department has done an excellent job of leading this informal forum in which regulators from the U.S. and Europe can discuss regulatory differences.

Finally, concern exists that the Treasury Department may not be appropriately staffed internationally. Consequently, I, together with Chairwoman Pryce and Ranking Members Frank and Maloney, commissioned a GAO study yesterday to assess Treasury's international staffing structure and whether changes can facilitate the Department's conduct of international economic policy.

We at the Committee share with you an interest in insuring that the Treasury Department has adequate staff and a good structure to meet the strategic economic policy challenges of the 21st Century.

I now yield to the gentleman from Massachusetts,
Mr. Frank.

Mr. FRANK. Thank you, Mr. Chairman.

Mr. Secretary, welcome again, and I will, in the question period, get into the debt relief question, because I think this is an important opportunity for us. But I want to talk about here is the issue you that affects both the international economy and our own, and it is obviously the number one issue for us, and that is our own economic picture.

I am troubled. We have had, in the past couple of years, a good degree of economic growth. What is troubling to me is that this economic growth has been accompanied by less job creation than historical standards would have predicted. The best job creation that the Administration has predicted and even with the job creation, a stickiness in wages, stickiness being a nice word for they ain't going up. What we have seen consequently is an erosion of the position of a large number of average Americans.

I have problems with that from the standpoint of equity. I think it is troubling when the country grows but inequality also grows. I welcome for the fact that, for instance, Chairman Greenspan of the Federal Reserve agrees that that is a problem.

But growth can be an economic and political problem. It can be a economic problem if we begin to see kind of a slowdown in consumer spending, which could be the result of this lack of income in those categories. It is clearly already a political problem. You have now an increasing degree of resistance on the part of a lot of Americans to the kinds of things you advocate in the international field, because they see themselves as the victims of globalization rather than participants in the benefits.

We are reaching an unhealthy state in the country, not just internationally but domestically, where there are more and more people who feel that they read good news but they are not getting much of the action.

Now, let me document what I am talking about. I want to talk about some statistics on job growth the ups and downs of job growth.

In June of 2003, the Council of Economic Advisors in this administration said that we would get job growth of 305,000 per month—305,000 jobs. They do pay a little bit more than the dollar. 305,000 jobs per month. That was the prediction in June of 2003.

Then in October of 2003, Mr. Secretary, you were the more realistic than the Council of Economic Advisors. You said everything you knew about economics said we would get 200,000 per month.

Then the CEA decided you were a piker, and they raised you and themselves in the 2004 economic report to 325,000 a month. This year's economic report, suddenly, you are the optimist again, 175,000 a month.

So, on the projections from the Council of Economic Advisors, it is very troubling, and there is no explanation of this. I read the Council of Economic Advisors report, and maybe you have to wait

for the DVD to come out, but we have gone from a projection from the Council of Economic Advisors to 325,000 jobs created a month to 175,000 jobs created a month a year later. We lost 150,000 jobs a month just looking at the CEA report.

Now the problem is that with all of those, and you were the low man in the prediction until the CEA came out again at 175, you were 200. But, in fact, for the five quarters since we started this recovery, and since you made your prediction in October of 2003, the actual total has been 165,000 a month. There have been a couple of good months, but there have been a couple of really lousy months.

You said, Mr. Secretary, that everything you knew about the economy said, we would get 200,000 jobs a month. Well, we have had 165,000 a month since then. That is troubling. I don't think it is you learned the wrong things, I think it is that we have new things in the economy. I think what we are doing is we are seeing a situation in which what is good news can become bad news, the bad news is that productivity is going up and that we are able to make more things. We are able to provide more services. We are able to create more wealth with fewer people.

But because of our social arrangements, we are turning that good news into bad news for some people so that we appear to be getting fewer jobs per unit of increased wealth than we used to. Again, your number was 200,000. We had 165. The Council of Economic Advisers—this has not been very well noticed, but the Council of Economic Advisors—I would have thought this would have required a little bit of explanation when you go from projecting 325,000 jobs per month in 2004 and a year later you project 175,000 jobs per month.

Now, I think that is an implicit recognition that things have changed in the economy. There are limits to what government can do. I will close this briefly. There are limits to what government can do to undo that trend.

But here is the problem. We are in a situation where it does appear, contrary to all the predictions that have been made, that things have come about in the economy, where wealth is less evenly shared than it used to be. What it would seem to me appropriate would be for the public sector in that situation to try to mitigate the consequences of this increased inequality. Instead, and this is where I fault our public policy, we have exacerbated it.

So we have a national—we have economic trends, national economic trends, globalization, productivity, information technology which tend to exacerbate inequality, which tend to allow us to create more wealth with fewer jobs. Public policy has unfortunately been reinforcing that tendency rather than trying to slow it down. The consequence is a country which is becoming increasingly hostile to many of the measures you want to think—I will be supporting debt relief for the highly impoverished highly-indebted poor countries.

I am very glad we don't have a national referendum on this subject, because while I think it is a very important thing for us to do, I don't think we could carry a referendum nationally on that because of the kind of resentment that is building up because of

these kinds of figures, so I hope you will help us figure out what we do if not to stop this trend, to at least mitigate its effects.

The CHAIRMAN. The gentleman's time has expired. The gentlelady from Ohio, the chairwoman of the subCommittee.

Ms. PRYCE OF OHIO. Thank you, Chairman Oxley, and welcome, Secretary Snow. Thank you very much for taking the time to discuss with us the state of the international financial system. We all know that the health of the U.S. and the EU economies are inextricably bound together in trade and cross border investment flowing and linking our capital markets.

The recent historic enlargement of the EU, through the accession of 10 new Member States, only magnifies that region's importance. The increasing closeness of the U.S.-EU relationship has underscored a growing trade in financial ideas, talent, technology and capital across the Atlantic.

I commend you, Mr. Secretary and your staff, for opening a dialogue with the EU dedicated specifically to financial services issue. I hope to hear more during this hearing on how the Treasury is working to improve trade in financial services between the U.S. and the EU.

Mr. Secretary, as you know, U.S. and international financial regulators have been negotiating the capital requirements for banks in the Basel Committee over the past several years. Many of us are concerned about the seeming lack of transparency in this process as well as cooperation among our own regulators.

I know other members on this Committee share my concern and would appreciate your thoughts on the Basel II process, specifically first noting how the U.S. regulators are working together, and, second, the competitive impact Basel might have on banks that do not opt in.

Additionally, the G-7 recently made a political commitment to provide "as much as 100 percent debt relief" to relieve the debt burdens of the poorest countries in the world, but they failed to provide a view on how this could be funded. In light of the G-7's agenda on development and debt relief for this year, I am hoping you will touch on recent discussions to have the IMF sell some of its gold stock and use the anticipated profits to relieve the highly indebted poor countries debt.

As you recall, the last time this idea was raised in 1999, the initial creation of the HIPC program brought it about, gold prices plummeted to a 20-year low. News of the G-7's proposal to sell gold from the IMF stockpile to pay debt relief sent gold prices down again last October, not only affecting the gold-rich United States, but also the developing countries that depend on their own gold for export revenues, the very countries that we are trying to assist.

Finally, as the Chairman noted, and I am sure you are aware, U.S. law prohibits the Treasury from engaging in negotiations on this matter without consultation and approval from the Congress. So we will be waiting to hear from you or not to hear from you either way on that.

I do thank the Secretary for his appearance today. I look forward to your testimony.

With that, Mr. Chairman, I am happy to yield back any balance of my time.

The CHAIRMAN. The gentlelady's time has expired.
The gentlelady from New York.

Mrs. MALONEY. Thank you, Mr. Chairman and welcome, Secretary Snow, and thank you for being here. Given the time constraints, I want to highlight three areas of great concern to me. The deficit, a debt relief and international cooperation in the war on terror. Mr. Secretary, as you are well aware, this Administration holds the absolute record for debts and deficits. Over the last 4 years of the Clinton administration, President Clinton reduced the national debt by a total of \$453 billion, and he turned over to President Bush a \$236 billion surplus and a national debt of \$3.3 trillion.

Yet the budget that the President has sent Congress for the coming year projects a deficit of over 390 billion, a record high, and a debt of 5.1 trillion, another record high, and this Administration has voted three times to raise the debt ceiling to over \$7 trillion.

This budget does not include the future costs of Iraq or Afghanistan missions, nor does it include the CBO estimated 1.9 trillion cost of making the President's tax cuts permanent, and it does not include the projected 2 trillion more dollars that the Republicans want to borrow from foreign countries for the private accounts that will change and undermine Social Security as we know it.

Just this month, we learned we had another record, another unfortunate record, and this was with the trade deficit and goods and services of well over 61 billion in February, again, a record high for a single month. The goods and services deficit was a record of 617 billion for all of 2004, again another unfortunate record for deficits that this Administration has given to us.

The broader current account deficit, which is the best measure of how much we have to borrow from the rest of the world, was a record 655.9 billion in 2004 and it hit yet another record 6.3 percent of the GDP in the fourth quarter of 2004.

I am concerned that should foreign investors lose confidence in our economy and reduce their investments, our constituents could face serious consequences, including a dangerously weak dollar and increased credit card, home mortgage rates and a sluggish economy, to say the least.

While the Administration claims its new budget will address the situation, the Bush record is consistently rosy predictions followed by a consistently ballooning deficit and debt. The budget put forth by the Administration for fiscal year 2004 which allows similar proposed caps to nondefense discretionary programs would seem to be more of the same.

I am also interested, as are my colleagues on both sides of the aisle, and your comments on the Administration's support for the heavily indebted poor countries. I strongly support the HIPC program. I personally authored a debt relief bill for Iraq with Chairman Leach just last Friday.

I joined with other members of the Committee, too, Mr. Secretary, in urging you negotiate over the past weekend multilateral debt cancellations to poor countries.

I am also very, very concerned and look forward to the update from you on the cooperation the Department is receiving on the international effort to track and cut off terror financing. I am con-

cerned by the news in many of the financial papers today of the third day slide in the stock market, the continuing slide in the dollar, and what does that mean for our country.

I, likewise, join this Committee in its joint effort on the Basel decision to make sure that our financial institutions are not disadvantaged in capital requirements in the world global market in the competition that we face in the global economy. So we have many challenges ahead of us. I am deeply, deeply concerned over a never-ending debt deficit, trade deficit, all record highs.

One of my constituents has given the country what he calls a debt clock, and is placed on 42nd Street and 7th Avenue. Every day it puts up the debt which every man, woman and child in this country owes to the Federal budget, the debt that each of us carry. It is well over \$26,000 per individual. This is extremely troubling to me, and very strong indicators of trouble ahead in the economy.

So I hope—I look forward to your testimony today, and your comments. Thank you.

The CHAIRMAN. The gentlelady's time has expired. We now turn to our distinguished witness, Treasury Secretary Snow, and I know that technically you are not here voluntarily, because you are required under the law to testify before this august Committee once a year. Actually, in the first quarter, according to statute.

So that time is running out on that first quarter, and we appreciate your appearance here today, Mr. Secretary, and look forward to your testimony.

Mr. FRANK. Time has run out on the first quarter.

The CHAIRMAN. Yes, I guess we have—by the way, the energy bill keeps an extension of daylight time by 1 month on one end and 1 month on the other. So I guess if we can do that, we can effectuate your testimony in the second quarter.

STATEMENT OF HON. JOHN W. SNOW, SECRETARY, UNITED STATES DEPARTMENT OF THE TREASURY

Secretary SNOW. Thank you very much, Mr. Chairman, Ranking Member Frank, Ms. Pryce, Mrs. Maloney—Congresswoman Pryce, Congresswoman Maloney. It is always a great delight to be up here before this Committee, and whether I was required to or not, Mr. Chairman, I would welcome the opportunity to share thoughts with you on the important subject of the international economy and where things stand, where we see it going and trying to take it, what some of the pressure points are and what we are trying to do with them.

We just concluded the spring meetings of the IMF and World Bank, where finance ministers, development ministers, Central Bank, governors convene; we also held a meeting of the G-7. And I think it would be a fair assessment of the conclusion of these meetings that the world economy seems to be in good order, in sort of a sweet spot. We have seen high world growth rates, the highest growth rates according to the IMF and World Bank in 30 years.

The United States is leading the way with the highest growth rates among the industrialized world. There are no recessions in any major economies anywhere. There are no financial crises in any major economies anywhere on the globe. A marked contrast to circumstances we have seen in the past.

We think good policies promoted by the United States government are helping to contribute to higher growth, greater prosperity and more stability in the world economy. There are three principal goals of the Bush administration when it comes to our international economic agenda, and it won't surprise you, increasing economic growth is a critical part of it, raising standards of living and reducing poverty across the globe.

Secondly, stability, increasing economic stability, allowing for steady growth in the economy and reducing the hardships and sufferings that result from financial crises.

As I say, I think the world is in a much better order today than has been the case in the past. Thirdly, we want to use our international economic policy to advance our foreign policy objectives, combating terrorism, promoting the reconstruction in Iraq and in Afghanistan, spreading economic freedom throughout the Middle East, through the broader Middle East, North Africa initiative, things like that.

I think we are making pretty good progress on a lot of these fronts. As I say in the developed economies, the United States is leading the way. We grew at 4.4 percent over the past 12 months, creating 2.4 million jobs over that 12-month period, coming in at about 200,000 jobs a month, as Mr. Frank indicated.

It is the result, I think, of the inherent strength of this economy. It is resilient, it is responsive, it is adaptive. But it is also the result of well-timed monetary and fiscal policy.

I give high marks to Chairman Greenspan and the Federal Reserve. I think they pursued a set of policies that were appropriate, accommodating higher growth levels that were needed in job creation. I give credit to the Bush administration and the Congress for acting on the fiscal policy front, reducing tax rates that clearly, in our view, helped stimulate the economy and move it forward.

We can't rest; we can't be complacent. As Mr. Frank indicated, there are problems. We need to deal with them. We need to keep pressing forward to improve the performance of the economy. To do that, I would agree with you. We are reducing the deficit which, Congresswoman Maloney, has to be a priority. We are focusing on that and want to talk to you about that. There are other things that are important, dealing with these large unfunded obligations for the future, represented by things like Social Security, while preserving and protecting the promises of the system are important.

You know, the President has called for broad-based tax reform, appointed a panel, a panel that appoints reports to the Treasury Department here in a few months, the end of July. I would see us engaging with you in broad-based tax reform later this year. Regulatory reform is very much on the agenda, as is energy legislation.

As I look at our trading partners in the G-7, I am struck by the fact that we in the industrialized world are suffering from what can only be styled a growth deficit. That has serious implications for the developing world, as well as for the United States and the trade deficit itself, which is directly related to lower growth rates in the rest of the world.

Japan, the second largest economy in the world, is showing improvement but it is still growing at a rate that is well below its potential. The same is true of Germany. The Euro zone as a whole

is lagging, growth rates less than half the United States. That means they are creating less disposable income there, compared to the disposable income we are creating, which directly relates to this question of the current account deficit.

At the G-7, we have established something, and this is joined in by all the members of the G-7, something that we initiated, called the Agenda for Growth, where recognizing the need for more growth in the global economy, each of us is committed to take on in our own countries and through our own political, administrative and regulatory processes, the things that most stand in the way, the things that most impede growth in our economy.

There is a real commitment to do that. Progress is slower than we would like to see, but progress is real. There is a commitment. It is not a commitment just of word, it is a commitment of actions. We put a clock on ourselves and we audit our open results, and that audit process will be the subject of the October meeting of the G-7.

In the emerging market countries, I think the most notable things there that I would remark on is the fact that economic growth is very, very strong. Latin America came in last year at about 6 percent. The emerging Asia countries came in at over 7 percent. The emerging European—the so-called succession countries—the emerging European countries came in at well over 6, 6.5, all in the absence of financial crises and all with spreads on paper that are moderate and all with inflation down.

This is a truly stark contrast to the 1990s,

Mr. Chairman. Why has this happened? I think it is because better policies are being put in place by these countries, through the leadership, the political leadership and economic leadership, better economic policies make a difference. We are seeing better economic policies applied, better fiscal policy, better monetary policy and there is no better example of this in my view than what President Lula and Finance Minister Palocci are doing in Brazil, which has turned the corner and is producing really strong and very good results.

Let me comment briefly on China. I know that is on the minds of everybody. Our policy, with respect to China, clearly calls for them to move to a flexible exchange policy. We have urged them to take the steps to get their economy ready for a flexibility exchange rate. They have taken a lot of steps, we can discuss them later.

They are now, in our view, ready to move to greater flexibility on their exchange rates. My colleagues and I at the G-7 have called on China to move to greater flexibility. We did so in the communique that was issued just over the weekend.

On the developing countries, in the poor developing countries, we also see significant progress in lifting people out of poverty. Clearly the prime cases here are China and India, which are moving at a rapid pace with very substantial growth rates, 7, 8, 9 percent. Millions, actually tens of millions of poor people have been lifted out of poverty because of the progress in those countries.

In sub-Saharan Africa, which is still a troubled part of the world, with population rising and concerns about growth rates rising fast enough to sustain higher standards of living, I am pleased to say

that growth is now estimated to have been about 4.5 percent over 2004. It can be better, it will be better, if we follow the right policy. We want to support those policies. 4.5 percent is a nice pickup from where they have been.

That is a result of their policies and the stronger, the stronger world economy. One of the Committee Members asked me to comment on the reforms of the international financial institutions. We are pressing them hard for reform agenda. We have called for a strategic review. We have asked for them, working with the G-7 and the other board members to think through their mission.

The fundamental conditions have changed dramatically from the time they were put in place. The World Bank was put in place initially to deal with the post-conflict situation in Europe, reconstruction of Europe after the Second World War and quickly moved off into other arenas.

The IMF was put in place to deal with a balance of payments adjustments in the context of a fixed exchange rate. Now, of course, large parts of the world have flexible or floating, freely floating exchange rates.

So we are working to make sure the missions of these agencies are appropriate to the current conditions of the world economy.

We are pressing those multilateral development banks, I think you would agree we should, to produce measurable results to put greater focus on grants rather than loans, to end this cycle of give, forgive, give, forgive. The paradigm of it creates the unsustainable debt levels.

We are also encouraging on the subject of using private sector-led growth of nurturing the private sector as the best engine of long-term growth and of creating an environment of respect for law and property, anti-corruption regimes, that will encourage foreign capital coming in, and, of course, importantly, encouraging transparency, encouraging real accountability.

One area where the United States is taking the lead, an area I know is very important, Mr. Chairman, to you and to the Committee, is on the effort to reduce the debt burdens on poor countries.

We have a proposal to reduce the debt, cancel the debt up to 100 percent for the HIPC countries. I think we made some progress over the weekend in building support for our 100 percent debt cancellation proposal with our colleagues in the G-7, a subject we will return to at the G-7 meetings in June.

The subject of trade has come up in your comments, critically important that we continue to push for open markets, trade liberalization, for financial services. This is a priority for us in the Doha Round trade talks and in our bilateral FTAs. It is important that we make progress here for ourselves, for the rest of the world and for the global financial system.

Finally, I think we are making, real progress on the subject of antiterrorist financing. We will come back to that, I am sure, as we go forward. The World Bank, the IMF, the multilateral development banks now have active participants in this effort to set standards, to audit, to be vigilant, to shape the global effort to deal with antiterrorist financial activities.

At every meeting of the G-7, we have a session on that at every meeting of the APEC, at every meeting of the G-20. This is very much a matter of intense focus on part of the finance ministers and central bank governors of the world. I was pleased by the legislation last year to strengthen Treasury's hand, as you mentioned, and we have now appointed an under secretary, Stewart Levy, who is playing a critical role in overseeing the terrorism and intelligence functions of the Department.

In that sense, the Department is really on the front ranks of dealing with anti-terrorism and national security.

With that, Mr. Chairman, I am delighted to try to respond to your questions.

[The prepared statement of Hon. John W. Snow can be found on page 46 in the appendix.]

The CHAIRMAN. Thank you, Mr. Secretary, for your testimony, and particularly at the end when you talked about the anti-terrorism activities on the part of the Treasury. And really, in many cases to the point of the spear as it relates to terrorist financing and the IFI issues. We met with Mr. Levy last week, and certainly he is energetic and focused on the task at hand.

Let me ask you about the G-7, since it is a recent meeting that took place. I think our country has shown great leadership in including first Russia and China in some of the G-7 events, and I think that perception clearly is also the reality that bringing in those two large countries, at least in part, has proven to be very effective, as has our work in the Middle Eastern countries as well. Other models with Brazil and Mexico, and the G-20 record for sustained growth, I think have all shown, as your testimony indicated, some real progress there.

On the other hand, there are those out there who have expressed concern that the G-7 is ineffective and is badly in need of reform.

Do you agree with this in a general sense?

Secretary SNOW. Mr. Chairman, I think the G-7 continues to be a very important component of stability and progress in the global economy and in the global financial order. We recognize that other countries are growing more rapidly, China, India, Brazil, and there needs to be outreach to them. But the G-7 remains the largest component of GDP in the world, and it is playing, I think, a true leadership role.

As you mentioned, we have tried to embrace other countries to broaden the dialogue. We have done that through having China come, Russia comes, other countries have come. We have tried to keep the agenda relevant, focused on the things that really count, global growth, risk to the global economy, stresses in the global economy, things, financial, the war on terror.

So I think it is a very important but can't be the only fora for bringing thoughtful consideration of these large issues that face the global economy.

The CHAIRMAN. I was, this morning, in New York at a conference sponsored by the EU dealing with the Euro and with the new regulatory structure in the EU. Will the EU enlargement going from 15 to 25 affect the EU members participation in G-7 meetings in any way?

Secretary SNOW. I don't think so, Mr. Chairman. It might affect some of the policies that are reflected in their comments. I am very positive about the accession. I think is going to add an element and dynamism and energy to the G-7. I think the Euro people, the Euro side of the G-7 feel that as well. But I don't think it would lead to a change in the composition of the G-7 itself.

The CHAIRMAN. Let me ask you about diversified capital flows, Mr. Secretary. Mexico and Canada last year purchased 55.4 billion in U.S. Treasuries, agency securities, corporate bonds and equities. China purchased only 47.3 billion and Euro zone purchased 45 billion.

These numbers would seem to indicate that we have a fairly diversified pool of capital coming into the U.S. market. Would you agree with that assessment?

Secretary SNOW. Yes, I would.

The CHAIRMAN. Do these statistics indicate that gradual diversification by Asian central banks of their U.S. dollar asset holdings might not be as significant as headlines might suggest?

Secretary SNOW. Oh, I think there have been a lot of misplaced headlines.

The CHAIRMAN. Well, that is a new one.

Secretary SNOW. Those headlines should have been in other parts of the paper or not occurred at all, given the factual content of the stories that followed.

The CHAIRMAN. Yes. I couldn't agree more. The statistics, then, do you feel fairly comfortable with them given the diversity out there? The diversification?

Secretary SNOW. Absolutely, Mr. Chairman. I am confident that the U.S., we know it is, and I am confident that it will remain an attractive place to invest. We have the deepest, the richest, the broadest, the most efficient capital markets in the world, and the best risk-adjusted returns. Our job is to keep them that way so we can continue to attract capital.

The CHAIRMAN. Finally, let me ask you, your testimony includes an impressive statistic, I thought, that I wanted to focus in on. That is: 5 percent expansion in sub-Saharan economies over the next 2 years would lift nearly 30 million people out of poverty. That is quite extraordinary, and I think we all share that commitment to what we are trying to do. Can these kinds of growth rates be achieved through development assistance and debt relief alone, or do we need to continue to push for trade liberalization?

Secretary SNOW. Oh, I think, Mr. Chairman, trade liberalization is really critical here. I had a meeting over the weekend with 6 or 7 of the finance ministers from the region, and was encouraged by their commitment to these good policies, by their commitment to routing out corruption. It happened just within a week or 2 that the President of Nigeria had, in effect, removed two or three members of his parliament and criminal sanctions were brought against them and against the Speaker of the House. Here is a country with a population that represents 20 to 25 percent of all of Africa adopting really good policies, committed to the right things. Minister Megosi is on the front of doing—of driving results, and there are other ministers and presidents in the region. It is something we just have to continue to reinforce.

Debt forgiveness will help. The financial support from the world community will help. But it will only happen, in my view, if good policy and trade opportunities continue to be the order of the day. We knew trade liberalization is awfully important for continued growth and prosperity in that region.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Massachusetts.

Mr. FRANK. Mr. Secretary, I agree with you on the importance of stressing anti corruption. I am not sure you picked the example most likely to appeal here when you cited a President moving criminal prosecution against the Speaker of the House and indicting members of the parliament. Maybe there are some other examples you might want to put forward in another context.

The debt relief question is important, obviously going forward with any corruption. Two words, I kind of perked up when you said we are for debt relief up to 100 percent. I want to help you get up to it.

There are a couple of issues here. One of the problems, I understand, is that some of the debt is IMF debt. I understand it is a smaller percentage overall. But I also understand that if you look at when it comes due, debt payments, debt service payments, IMF debt is a much greater percentage than 10 percent in the near term. It is also the case, while it is 10 percent across the board, that doesn't necessarily mean it is 10 percent for any one country.

What is the problem with also doing IMF debt? Now, I believe that we ought to go ahead with gold sales. I think we can do that. I think the gold sales we did previously were useful moneys, I will put in the record, Mr. Chairman, unanimous consent, a description of some of the benefits that came around from the last round of HIPC debt relief. We did this in a bipartisan way, was supportive and it had a good impact. Why not include the IMF debt?

Secretary SNOW. Well, Congressman Frank, the reason we are focusing on IDA and the African Development Fund is that is the great proportion of the debt.

Mr. FRANK. Why not do both?

Secretary SNOW. Well, I think we are building towards a consensus on the HIPC for IDA and the African Development Fund. I don't see a consensus at the other side of the IMF yet. We have had discussions on it. We will continue to have discussions. But we are right on the verge, right on the cusp, I think, an historic coming together, a meeting of the minds on the need for—

Mr. FRANK. I hear that, but I don't think there is a contradiction to working on that. To the extent there is arbitrary reluctance to do gold sales again, I think that is a great mistake, particularly if I am wrong, you can correct me, but according to the people with the data, who have generally been accurate, always accurate to me is, in terms of the debt service payments, about 50 percent right now is going to IMF debt, so even though the overall debt is less, given the timing of the debt, so that you really are only putting out a significant chunk by guarding that weight.

Secretary SNOW. As I say, Congressman Frank, whatever the merits of moving on the IMF side of the debt, we don't have anything close to the consensus, and we are focusing our efforts now—

Mr. FRANK. Well, you ought to tell—
Secretary SNOW.—on getting this done.

Mr. FRANK. You ought to negotiate with them. I think you ought to tell those people, whoever we weren't able to get a consensus, I hope you will be able to convey there will be considerable unhappiness if people think that is where we stop.

Simply with regard to IDA, and I appreciated Under Secretary Taylor, who has done a very good job with this, was very useful, and I agree that in addition to forgiving the debt, we should go to grants instead of loans. I disagree with people who for some reason don't agree with that.

But I then do—there is a fair question. What do we do about the future? Yes, you can deal with this in terms of the period of debt. You can do it by testing the debt relief. But what do we do to make sure that IDA is in a continued position to make those grants?

I agree with you that grants are better than loans, but to the extent that the loan flows were some of the source of revenue, are we committed to replacing that or are we making sure through our appropriations process that there will be funds going through for IDA?

Secretary SNOW. Yes, we indicated there would be no—under our policy, Congressman, there would be no reduction in net resource—

Mr. FRANK. Even if that would require appropriation going forward?

Secretary SNOW. Yes. We have said that we want to make sure that there is no reduction in the net, net flows.

Mr. FRANK. All right. I appreciate that, because I think, with that, then there shouldn't be a problem. Let me go back now to the job creation issue, because you said that—you had used the figure 200,000 again, but the problem has been beginning in the third quarter of 2003 when things start to get better, unfortunately the average is only 165,000 a month.

Now, you would have said 200,000 a month. But 35,000 jobs a month, as you know is quite significant. It makes a difference between getting to whittle down the unemployment rate and not, you are in that range. I know you are not responsible for the Council of Economic Advisors report, but aren't we entitled to some explanation of nearly a 50 percent drop in their projection about jobs.

In 2004, the Council of Economic Advisors said, it almost looks like there is randomness here. June of 2003, job projection by the Council of Economic Advisors, 305,000 per month. October of 2003, you say 200,000 a month. January of 2004, they are back up to 325. Now they are down to 175, and, of course, the reality has been below everything.

I mean, are people supposed to have confidence in this kind of bouncing around. At the very least, is there some reason why you are aware of that we have dropped in their projection from 325,000 jobs a month to 175,000 jobs a month in just under a year?

Secretary SNOW. Congressman, no, I am not an authority on how those estimates get made. As I recall, going back to my conversations with Dr. Mankiw, when he was chairman of the council—he has now returned to academic life.

Mr. FRANK. He took 150,000 jobs a month with him. Can we get them back?

Secretary SNOW. As I recall this, the job number that comes out of the—

Mr. FRANK. Black box.

Secretary SNOW. Well, out of this process, they call it the Troika process, is a residual. It is sort of what comes after you figure growth rates and inflation rates and interest rates and all sorts of other things in the macro economic model, and this is a residual of that. So it is not so much an active forecast as the result of other things in the model.

Mr. FRANK. Let me give you, Mr. Secretary, and I will finish, as someone who studied economics, I think about when you did, I share what I intuit is your nostalgia for the days when there were less formulae and more thinking and more words and fewer numbers when we did this economics stuff.

But I don't think it is truly—therefore, it does seem to me, looking at what you said, we do have to confront the prospect that we may be getting fewer jobs per unit of increased wealth than we were getting. We have to address that.

I mean, the fact is that during the period in which the economy has been growing and growth has been good, over five quarters, job growth has averaged 165,000. It has bounced up and around. But I think 5 quarters, 165,000, it is been bouncing around, there has been no trend one way or another. That is a pretty solid set of numbers. I think it leaves us with fewer jobs than you reasonably expected.

I think when you said that in October of 2003, you were reflecting historical experience. A year and a half later, it looks as if you were too optimistic, not because you were wrong then, but because of changes in the economy. I think we have got to begin to think about ways to address that. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired. The gentlelady from Ohio.

Ms. PRYCE OF OHIO. I thank you, Mr. Chairman.

Mr. Secretary. Chairman Oxley and I wrote to you on March 17th regarding our concerns that there is a looming crisis in the WTO services negotiations. Strong services provision in the Doha round are critical in our estimation. We were very happy that the services sector was finally given equal billing with agriculture and goods, thanks to a strong push by the U.S. and the EU back in July.

But what can we do to convince developing countries of the benefits of services liberalization and how can we get them to do the internal political machinations to develop offers? Free trade and financial services is as important as free trade in goods or agriculture, as anything else. I just would appreciate your perspective.

Secretary SNOW. Congresswoman, of course, I agree with you, it is absolutely critical. We were disappointed that more offers didn't come in earlier in the year, and Dr. Taylor and I and Mr. Quarles all reached out to our counterparts to suggest that, you know, you should accelerate your efforts here. I think that produced some results, some additional offers came in.

We are intent on making broad-based liberalization of financial trading, a key feature of the Doha round. I have talked with Mr. Mandelson, Peter Mandelson, who referenced Mr. Levine. I look forward to talking to Congressman Portman, as he takes on that new role.

We think it is absolutely essential and going beyond WTO, it is absolutely essential that the developing countries begin to do it with themselves and trade with themselves. Because when you look at the picture, an awful lot of restrictions are within the developing countries on trade with themselves.

But I want to assure you that this is absolutely a priority with us. I am going to be meeting tomorrow with EC Commissioner Troy on the subject of the dialogue and we will get into the subject of the services and opening up the transatlantic market. Mr. McGreevy and I will be talking about opening up the transatlantic dialogue on services. It is a priority for us.

Ms. PRYCE OF OHIO. Well there is a growing impression, I think, in some circles, that this is a hostage to agriculture issues, and do you share that opinion?

Secretary SNOW. Well, agriculture is really certainly the main act here. That financial services, we are going to make sure financial services doesn't get forgotten.

Ms. PRYCE OF OHIO. Thank you, let me shift gears. Ironically, the sale of IMF gold would impose a hardship on the very nations that the G-8 wishes to help, going back to that issue. Of the 38 HIPC nations, more than 30 are gold producers or potential producers. The falling gold prices in 1998 and 1999 resulted in the loss of 150 million in annual exports earnings to these nations, and it turned into job losses, wage decreases and tax disruptions, all kinds of things. So given that, why are the IMF gold sales considered by anyone to be a credible alternative for debt relief?

Secretary SNOW. You know, there is no consensus on this among the G-7 or the board of the IMF. I think that if you did a vote now, I haven't ever taken a vote count, you would have as many or more against than in favor of the gold sales. There simply isn't a consensus to move forward. The U.S. position is clear on that. It is inadvisable and not a course of action we could support, and we have made that clear. Why others continue to push for it, I don't know, but I don't see how they will ever be successful.

Ms. PRYCE OF OHIO. Well, I don't either, but each time it comes up, it shakes the market and I just wonder what is behind it.

But thank you very much, Mr. Secretary, for your appearance here today and your candid answers, I yield back.

The CHAIRMAN. The gentleman from Vermont, Mr. Sanders.

Mr. SANDERS. Thank you, Mr. Chairman.

Mr. Snow, good to see you again. Mr. Secretary, I find it hard to understand that, given the fact that last year we had a \$617 billion trade deficit, that we had \$162 billion with China, that any sensible person could continue saying that our trade policy is working when in fact the last number of years we have lost millions of decent-paying jobs because of PNTR with China and the NAFTA agreement.

Coincidentally, Mr. Secretary, this morning I was at an event in Winooski, Vermont, where many people have lost their jobs. I want

to ask you a very, very simple question. Up here, we make very good salaries. You make a good salary. You are a former CEO. If you were a worker in Winooski, Vermont, and you made \$10, \$12 an hour—and, yes, there are people in America by the millions who make \$10 or \$12 an hour—and if the Secretary of the Treasury of the United States of America said, in essence, that it is appropriate, it is okay, it is right for American workers to compete against desperate people in China who make 30 cents an hour and who go to jail if they try to form a union or stand up for their political rights, do you think that that is right? Should American workers have to compete against folks that make 30 cents an hour and go to jail when they stand up for their rights? Yes? No?

Secretary SNOW. Well, the reality is, of course, as you know, the United States lives in a big global economy; and probably the worst thing we could do for living standards of the American people is to seek to pursue isolationist policies.

Mr. SANDERS. Nobody is talking about isolationist policies. Do you think I should be telling those workers that the Secretary of Treasury says that it is right and moral for them to have to compete against desperate people who make 30 cents an hour?

I am hearing you say that that is globalization. Globalization didn't just happen. It happened because corporate America spent millions of dollars trying to get this Congress successfully to pass permanent trade relations with China and NAFTA, which is a disaster. It doesn't just happen. It happens because of policy.

I want to ask you another question. We hear a lot of talk about patriotism and love of country. When the CEO of General Electric, a fellow named Jeff Immelt said, I quote, when I am talking to GE managers, I talk China, China, China, China. You need to be there. I am a nut on China. Outsourcing from China is going to grow to \$5 billion, end of quote. What do you say to Mr. Immelt? Do you say, that is good? That is what we want American CEOs to do? We want you to move to China? Or do you say show some respect for American workers and the people who have made you a great corporation?

What do you say to people like Mr. Immelt—and it is not just him—for all of corporate America that is selling out the American people that have made their corporations great and given them huge salaries? What do you say to those guys?

Secretary SNOW. I haven't had a conversation with Mr. Immelt on that subject, but it is clear that we need to keep this economy of ours flexible, adaptive, open, so we can create all the jobs possible so that everybody who is looking for work can find a job, so that Americans continue to prosper in this new economy.

Mr. SANDERS. You know as well as I do that large corporations like GE are employing fewer and fewer Americans.

My next question would be, given the fact that corporations like GE, IBM, Boeing, you name it, are throwing American workers on the street and heading to China, do you think they should be coming in to the Congress and asking for billions and billions of dollars in taxpayer subsidies and tax breaks or would you agree with me that if corporations are throwing American workers on the street they shouldn't get welfare from the American taxpayer?

Secretary SNOW. Often, I guess, we are dealing here with the eye of the beholder, but as a general proposition I am not in favor of corporate welfare.

Mr. SANDERS. And you would share my concern, therefore, that in programs like the Export-Import Bank, we have given billions of dollars to large corporations who have thrown American workers out on the street and moved abroad?

Secretary SNOW. I don't know the specifics of that, but I am not a fan of corporate welfare. Now I qualify that by saying corporate welfare is often in the eye of the beholder. But as a general proposition, no, I am not a fan of corporate welfare. I think it results in a misallocation of resources and burdens that aren't justified by the benefits.

Mr. SANDERS. I look forward to working with you on some legislation.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from California.

Mr. ROYCE. Thank you, Mr. Chairman.

Mr. Secretary, nice to have you back. We are here today to discuss the international financial system, and GSE debt has become a major source of investment in the global marketplace. In fact, Japan and China together own close to \$200 billion in GSE debt. So, clearly, risk management practices of the GSEs do have global implications in terms of the effect on the markets.

I wanted to get some of your opinions on the current legislation facing our Committee. In my mind, there is a significant difference between a regulator task to oversee safety and soundness and one focused on systemic risk in the entire global financial system. I know you and Chairman Greenspan are concerned about the potential systemic risk of the GSEs. What does the Administration think about the language authorizing the regulator to limit portfolio growth in the current Baker-Oxley bill in H.R. 1461?

Secretary SNOW. I would like to look at the specific language. I support the intent to limit portfolio growth beyond what is required and necessary to sustain the primary mission of the GSEs, which is to make the secondary market.

Mr. ROYCE. Let me ask you this, Mr. Secretary. What kind of specific guidance is necessary for the regulator in this regard?

Secretary SNOW. Well, what I would propose is that the regulator operate in a statutory framework where there is recognition that systemic risk needs to be managed and dealt with; that systemic risk grows out of the ability of the GSEs today to grow their loan portfolios, which they have done in very significant—taken on substantial debt over the course of the last 15 years or so and invested in—in effect, arbitraging their low borrowing rate with MBSs and mortgage-backed securities and mortgage paper. And therein lies the potential systemic risk. The regulator needs to be alert to that.

I would hope the statutory framework, the legislative language, the report language would frame the issue that way and then direct the regulator to limit the holdings of the GSEs in their investment portfolios to the amount of MBS and equities and other mortgage assets, hold them to a level not greater, maybe with a cushion—obviously, with some cushion—a greater level that is necessary to enable the entities to carry on their specific statutory

mission in their charters to create liquidity for the secondary market.

They would be allowed to hold all the cash they wanted, would be allowed to hold all the near cash and the treasuries, but I think they need to be limited in their ability to invest in interest-priced paper beyond treasuries.

Mr. ROYCE. Thank you, Mr. Secretary.

Another question I wanted to ask you about, I chair the International Terrorism and Nonproliferation SubCommittee over in International Relations; and there was a report released last Thursday on the IMF on its technical assistance program to assess country implementation of the Financial Action Task Force standards. What this report says is that the IMF has been hampered because expected donor funding largely did not materialize. This is a pretty important area.

So I was going to ask you, why did the IMF expect additional funding for these reviews? Was the United States Executive Director to the IMF aware of these problems? And what can the United States do to ensure that implementation of these standards for the Financial Action Task Force is supported worldwide in the event that the IMF cannot serve as a partner in this effort due to their argument about resource constraints?

Secretary SNOW. This is a subject that is regularly under review with us and the IMF and the G7 and the other finance minister meetings. I have not reviewed that report yet, but I do know that there is enormous effort going into this standard-setting engagement and to building broad-based support, not just for signing up but for actually doing the implementation through the banking system and financial institutions and the bank regulators that is essential to make it work out. I will send you some comments on their report, but I have not seen their report.

The CHAIRMAN. The gentleman's time has expired.

Gentlelady from New York.

Mrs. MALONEY. Thank you, Mr. Chairman.

Mr. Secretary, a strong economy at home is going to help the world economy; and, as a New Yorker, I am deeply concerned about the need to act promptly to extend the Terrorism Risk Insurance Act. After the attack on 9/11, the one program that helped New York move forward more than any grant, more than anything, was the joint effort by the Chairman and Ranking Member with the leadership and support of the President and the Administration that created the Terrorism Risk Insurance Act. It expires at the end of the year.

I know you will be coming out with a report in June, and that will add greatly to the debate. But, right now, the financial service industry, the real estate industry and the business community at large are very, very concerned. They are knocking on the doors of Congress, wondering if we are going to move this program forward and reauthorize it.

And my question to you, what is your view on the need to extend TRIA? Will you be providing leadership? This is essential to the economy of New York City and I would say every major urban—Washington, D.C., and every area that is mentioned as a terrorist target.

Secretary SNOW. Yes, Congresswoman. We are moving along well with the study that you have asked us to do. I think the deadline for the study is the 8th of June. We plan to have the study up certainly by that date, hopefully even sooner.

I know it is an issue of enormous importance. We have had tremendous volume of input from both sides of the market, the insurers and the people who buy the policies. We are going to give it the best analytical effort we can. The support from the industry and the users of insurance policies has been terrific. But I better wait until we finish our report because I am not sure quite yet.

Mrs. MALONEY. Thank you, and keep a deep concern and focus on it. It is important.

If your explanation of the trade deficit is correct, that it is an imbalance of payment between exports and imports, why hasn't the weakening of the dollar caused the trade deficit to improve? It has gotten worse. With the weakened dollar, by that definition, would it not improve the trade deficit?

Secretary SNOW. There are a lot of things that affect that current account balance: differential monetary policies, differential savings rates, differential growth rates, differential rates of creating disposable income and differing expectations for currency values in the future and so on. It is maybe the single most complex set of economic relationships and impossible to model or really predict with any accuracy.

What we have tried to do is lay out the things we think are most important in that adjustment process. One is growth rates that I have talked about.

Second, higher growth rates in our trading partners so they will generate more disposable income and buy more from us. Second part of it, though, is the U.S. savings rates. We are saving too little. We know that and acknowledge it. The deficit is too high, as you suggested earlier, and I agree with you, and we have to bring the deficit down both short term and long term. We are trying to encourage higher household savings rates. They are nearly zero. We just don't save very much in the United States. So higher savings rates would help us.

Thirdly, we are intently focused on currencies that aren't flexible; and that is the Asian zone, primarily China. We have indicated that it is time for China, in our view—China has taken the steps to fix their financial infrastructure and time for them to move to a flexible currency.

The combination of those things is what it takes to address this global imbalance. People talk about the U.S. current account deficit. It is a shared deficit. And the other side of the Capitol dubs it that the current account deficit is the large capital account surplus. We have to view this as a shared responsibility.

Mrs. MALONEY. To finance our trade deficit last year, we had to borrow over \$650 billion from the rest of the world. What would be the consequences for the U.S. economy and the world financial markets if foreigners suddenly decided to dump our dollars? Is it good for the U.S. economy to be borrowing so much from abroad? You testified earlier, it is shared with various countries, China, Japan and Mexico and Canada. But won't the repayment of that debt and the associated interest costs be a drag on our future and

our future standard of living? And isn't it troublesome? This is the first time that we have borrowed so much from the rest of the world. And your comments.

Secretary SNOW. My comments are, I wish we had higher savings rates in the United States, wish our deficit would come down. I am confident our deficit will come down. We have proposals pending before the Congress to help savings rates go up. Sure, I wish we had higher savings rates. I also wish the rest of the world was growing a little faster so they would create more opportunities to use their higher savings for investments in their countries. And I wish China would move to a flexible exchange rate soon so that the adjustment that that would introduce to the global economy would be allowed to play out and it would have a beneficial effect, I am sure.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Texas, Mr. Paul.

Mr. PAUL. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. I want to make one real quick comment about something you had in your written report that I found fascinating. Seemed like you were praising the Japanese for moving to privatization of their post office, and I was wondering if that was a subtle suggestion to us that maybe we ought to consider the same thing.

But I am interested in your comments dealing with the need for international financial stability as well as economic stability; and, obviously, I think we all are. In answer to one of the questions, you talked about why the lower dollar so far hasn't sorted out our current account deficit. But the one issue that wasn't mentioned, that I think is important, that someday we have to think about, and that is the special status that the dollar has.

As a remnant of the gold exchange standard which ended in 1971, we still have a currency that is recognized as a reserve currency. So, therefore, it gets a bonus and people are more willing to hold dollars than any other currency. So we don't save. We supplement our savings with the creating of credit out of thin air, and then we spend it. In some ways, the instability or the lack of the arrangement we want with the Yaun is actually a tremendous benefit for us because we print money and then we spend it over there and we get cheap goods.

When the day comes when finally there is a flexible exchange rate between the Yaun and the dollar, some people are going to be unhappy because interest rates may go up and it may have a cascading effect and others may want to raise their currency in relationship to the dollar.

So I think we are far from stable. When you gave your optimistic report at the beginning, I hope it is all true, but I was tempted to knock on some wood in hopes that it truly is that positive. But I just think that the nature of the currencies, when every country is putting money at a different rate, there is no anchor to it. It is naturally unstable, and we have a lot more to deal with than any of us realize.

In talking about debt relief, I am interested in this subject as well because we talk about selling gold and getting the currency to help debt relief, and we talk about appropriations. But I would like

you to comment on this when you get a second. Why is it we need to appropriate money? Why don't they just default? This whole idea that you have to first loan them the money, then they don't pay it back and we have to appropriate money so they can pay their debts off. It seems like they ought to default and there should not be any need to sell gold and should not be any need to appropriate more money from the American people.

I assume from your comments that there is not going to be a request from the Congress to agree to sell the gold. Is that more or less what I should expect?

Secretary SNOW. Yes.

Mr. PAUL. No request. But gold essentially by the financial community and our governments and international monetary fund, everybody has agreed that gold no longer is money. Either the money was stolen from the American people and was taken from them at \$20 an ounce—we defaulted on the bonds. We defaulted with the foreigners at \$35 an ounce in 1971. That is stolen money. Why isn't it just returned to our government? And why doesn't our government that no longer wants to use gold as money, why don't we sell this gold? Why is this clinging on to gold when it is no longer money? How do you look at this gold issue?

Secretary SNOW. The gold is part of the financial reserve of the IMF. It is, in effect, a balance sheet item at the IMF. They have very substantial gold reserves which they carry on their books, and it represents a substantial part of the basic assets of the Fund. So it affects their financial condition.

Mr. PAUL. Why do we have to appropriate money to pay off debt? Why can't they just default on the debt they owe? Why would we have to sell the gold?

Secretary SNOW. It is because of the way we budget debt. When we take on these obligations, it becomes a budget item in the U.S. accounts.

Mr. PAUL. We just can't write it off?

Secretary SNOW. Well, we need, basically, Congressional approval.

Mr. PAUL. Is the debt owed to the government or to banks, private banks?

Secretary SNOW. The debt we are talking about here is owed to the multilateral development banks, to basically IDA, which is a part of the World Bank, and to the African Development Fund. Those two entities hold most of the debt we are talking about.

The CHAIRMAN. Gentleman's time has expired.

The gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you very much, Mr. Chairman.

Welcome again, Mr. Secretary. Always a pleasure. Going to ask a series of questions, if I may, so work with me in my 5 minutes.

First, it is true that the G7 is going to be meeting in Scotland in July and on that table will be the issue of a plan to ease the debt particularly to the impoverished nations. Given the concern that terrorists are one of our biggest concerns in the fight against terrorism, these impoverished countries are basically incubators because of that poverty. With that understanding and background, knowing we have an extraordinary obligation to deal with this, where is the problem between Great Britain and the United States

that is preventing at this point an agreement on how we are going to come up with a plan to deal with world debt as it affects these impoverished countries and what do you expect to happen coming out in July?

Secretary SNOW. Congressman Scott, I can give you an optimistic answer there. I think the U.S. and the U.K. are narrowing their differences as we develop a better understanding of each other's approach. I am talking about IDA and the African Development Fund. We are really getting close.

I had a good chance to talk with Chancellor Brown over the weekend, and Dr. Taylor talked with people in the British delegation. We are in continuing discussions with them.

I think we can narrow the differences to the point that we are almost in agreement. I think we now agree on 100 percent forgiveness. I am not sure they are fully to where we are in going forward saying it is all grants and not loans. In other words, for a long period, you don't make any more loans, you just give grants. But I think there is a movement there.

I think we have narrowed our thoughts—they keep talking about additioinality, more money going in. We keep saying, let us make sure there is no net reduction in resources going into the HIPC's over this time. We are understanding them better, and they are understanding us better. I think really good progress is being made. I look forward to meeting with the Chancellor and our British counterparts in June when we are in London this time in anticipation of the heads of state meeting. I am encouraged, and so are our British counterparts.

Mr. SCOTT. Is the point of contention in the fact that we all agree in alleviating the debt but that the United States is balking at wanting to give more aid?

Secretary SNOW. That issue is part of the difference, but we have indicated that there may be a misunderstanding there. We are committed to making sure that the net transfers remain the same, that there is no reduction for the HIPC's and for the other non-HIPC poor countries in the resources available to them. I think there may have been confusion on that score. We don't think you have to put more money in. We are prepared to talk about that.

But if you forgive all the debt, and that means the debt service goes as well and you don't take on additional debt for this extended period of time—I think it is 2010 we are talking about—I mean, 2015—and during that time grants occur, the balance sheets of those countries will improve dramatically and the reflows, that is the payments on the debt service, are not required, it is going to put the HIPC countries in a much better position.

Mr. SCOTT. I have a little bit more time, and I have two more questions I wanted to get to. We have been receiving some complaints from foreign countries doing business in this country on being able to follow the rules with the Sarbanes-Oxley law. We will be having hearings coming up on Sarbanes-Oxley. Do you recommend—in relationship to responding to these complaints from foreign countries, do you recommend any changes be made in Sarbanes-Oxley?

Secretary SNOW. No, I wouldn't; and I think the SEC has shown—I don't think you need changes in the basic law. It is a

matter of implementation. I think the SEC has shown some good flexibility here, some good accommodating behavior on the part of the regulator to deal with the problems of—that our European counterparts have had.

I am sympathetic to some of their concerns. We have a notion of independence in a director that is somebody who has no major stake in the firm other than being a director. He is not a consultant and not being compensated by the firm, is disinterested. Some of the European countries have a different conception of a corporation, where suppliers of services to the company are like labor and expect to be on the board. We have to find a way to get convergence, and that is the very subject of the U.S.-E.U. dialogue that the Treasury is chairing.

Mr. SCOTT. I want to get this last point in. We are involved right now in trying to provide leadership on simplification of the Tax Code and tax reform. You mentioned the commission the President has put forward, and later this summer we are coming up with recommendations on that. Wouldn't this be an excellent opportunity to address one of the issues that you pointed out we need to for the future of this country, for the economic health of this country, which is increasing our savings and our investment, if we could find a way as we are addressing reformation of the Tax Code that we put incentives into the Tax Code to encourage savings and investment?

Secretary SNOW. Absolutely. Absolutely. I think the Administration has come forward with some proposals along that way. There may be better ways to do it, but absolutely.

Mr. SCOTT. We have legislation moving in that direction. Would you support us on that?

Secretary SNOW. I support the broad idea of encouraging savings, and one good way to do that is to allow investments to build up in accounts in a tax-free way or go into the account in a tax-free way so that the tax bite on savings is lower. Yes, that broad idea is something that I certainly support. The details we would have to look at, but the broad concept I support.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Georgia, Mr. Price.

Mr. PRICE. Thank you, Mr. Chairman.

I appreciate the opportunity to ask you a few questions. I welcome you back, Mr. Secretary; and I want to comment how judicious it was for you to respond to the inquiry about changes to Sarbanes-Oxley in the manner in which you did. I noted the smile on the face of the Chairman.

Oftentimes, we hear comments from folks who you would think that they were Chicken Little and the sky was falling as it relates to our debt and our deficit. And although neither are exactly where we want them to be, I wouldn't mind if you would please share with the Committee your comments about our debt and deficit level vis-a-vis the world economy, the international economy, and how it is viewed in that light.

Secretary SNOW. Well, you are right. I mean, we are working hard to bring our deficit down and our debt to GDP levels down, because they are higher than we would like to see them. But we are in a pretty good spot relative to most of the rest of the world.

Japan has debt levels that are over 100 percent of its GDP. We are in a much better position than most of the rest of the world. We can't be complacent about it. We have to continue to focus on it. But I am confident, as we do, we are going to find our deficit level come down to a level which will be low by historical standards, below 2 percent of GDP, and that is going to occur because we keep the economy strong and revenues come in and spending—tight spending controls as you are doing in the Congress. I feel very good about the path we are on for the fiscal deficit. The larger issue seems to me to be those outyears with the unfunded obligations.

Mr. PRICE. What about in your conversations with financial leaders from around the world and the bigger picture of them looking at us? What kind of comments are they making to you regarding our debt and deficit?

Secretary SNOW. The G7 ministers and the IMF people, the central bank people I have talked to take us at our word that we are committed to bringing the deficit down and we will bring it down and they applaud us for that. And they recognize that the United States has gone through a tough time. We have had a recession. We have had the terrorist attacks. We have had corporate scandals that led to the Sarbanes-Oxley legislation. All of this had its effect on the revenue side of the government, reducing the revenue government revenue stream. We are now getting the revenue stream coming back up; and that combination of the economy strong and the revenue stream coming up and some decent controls on spending—I think we will clearly get us to where we need to be. The rest of the world wants us to get there.

Mr. PRICE. Is it fair to say that the rest of the world hasn't lost confidence?

Secretary SNOW. It is fair to say that the rest of the world still has confidence in the United States and depends on the United States as the strongest engine of growth in the world economy. I think we have got their respect and confidence that we are committed to dealing with the deficit issue and putting it on a path which is the right path to be on.

Mr. PRICE. I will yield back my time.

On the issue that Mr. Scott raised and others have raised and you raised about our savings rate, which is woeful, I think we had Chairman Greenspan here awhile back, and he commented on the types of mechanisms to attempt to increase savings in our Nation. One of the manners in which that can be most successful would be to move toward a consumption tax, as opposed to our current structure. Would you have any comments about whether or not a consumption tax increases the rate of savings?

Secretary SNOW. By its very nature, that is what our consumption tax does.

Mr. PRICE. A consumption tax by its very nature would assist in our debt and deficit, or as it is viewed in relationship to our global economy?

Secretary SNOW. The idea behind the consumption tax is that you don't tax savings and investment. You tax consumption. And the nature of such a tax system would be to tilt towards more savings and more investment.

Mr. PRICE. Which is a good thing.

Secretary SNOW. I think we need more savings in this country. I don't want to comment on what is going to come out of this panel. I want to wait for the results of this panel. But, clearly, that is the argument for a consumption tax.

Mr. PRICE. The gentleman yields back.

The gentleman from California Mr. Sherman.

Mr. SHERMAN. Thank you.

I would like to identify myself with the comments of the gentlelady from New York on terrorism insurance and say that we also ought to look at disaster insurance being treated the same way. If this country suffers a 10 or \$20 billion catastrophe, it doesn't matter to many whether it is a manmade or a natural catastrophe.

We do, I think, have huge problems with Sarbanes-Oxley affecting smaller public corporations, but I know we are going to have hearings on those in this Committee. I won't take your time with those.

My first two questions, I will ask you to respond for the record. The first is on the World Bank, which has provided over recent years \$1 billion of concessionary loans to the Iranian government. We are subsidizing the very government that is building nuclear weapons, that will either use them or threaten to use them against the United States or its allies. I have offered legislation to give the Administration the power to take money appropriated from the World Bank and instead use it on AIDS worldwide. Secretary Powell praised the legislation, but, unfortunately, your Department has failed to embrace it. I would hope we would do more than just have tea and crumpets after voting no each time the World Bank votes to lend money to Iran.

Second, when it comes to China, it flabbergasts me that we have, in effect, acquiesced to many years of wrongful currency manipulation as if China will eventually stop shafting us, that is okay. I hope you come to the San Fernando Valley and talk to people who have lost their jobs and families and became addicted to alcohol and lost their lives and explain to them that it is okay because China will stop doing to thousands of American families eventually when it finally is begged into ceasing its wrongful currency manipulation.

But I do want to focus on the huge trade deficit. The world economy is built on a house of cards or a house of dollar-denominated security certificates, built like a house of cards in the vault rooms in Europe and Asia. And these huge trade deficits result from three major causes: a failed trade policy in both the Clinton and Bush Administrations, our enormous Federal deficits in the last 4 years, and currency values which have adjusted a little bit. But it is your Department, Mr. Secretary, that puts forward the strong dollar policy. We have seen an end to the slide of the dollar. And while the slide of the dollar doesn't fill us with joy, it is the most benign possible outcome of this terrible circumstance where we have borrowed and borrowed abroad.

I would urge you to change these three major policies, but I know you are not going to. Instead, what I would ask you is, are you willing to explore a plan to deal with a possible catastrophe, that is to say D day, the day the dollar drops—and I don't mean by one

quarter of 1 percent in a day; I mean like 10 percent in a day or 30 percent in a week—the day the house of cards collapses? Will we be in a position, perhaps working with others, to freeze currency markets that are in a free fall, to freeze stock markets that are in a free fall?

I will point out that it is perhaps unlikely that things will unravel this particular way, but it is unlikely we would have a tsunami in the Indian Ocean, and we just did. Given the fact that this could be more destructive than that tsunami, are you working not to embrace the idea that the dollar would crash or to suggest that it was even a significant possibility but rather to know that we are prepared to deal with a tsunami if it hits us?

Secretary SNOW. Did you want me to offer verbal comments on Iran and China or just for the record?

Mr. SHERMAN. I would for the record on Iran and China. Because, unless the Chairman yields more time, I would like you to focus on some sort of circuit breaker and emergency policy if the dollar declines suddenly, which is a possibility if not a probability.

Secretary SNOW. What we are trying to do is make sure that we have stability in the global economy and we don't confront disruptions.

Mr. SHERMAN. Mr. Secretary, we can't continue forever to borrow half a trillion dollars and call it stability. That is the stability of building a house of cards. It looks stable until it caves in.

Secretary SNOW. What we are saying is we want to build the forces of adjustment in the global economy that will lead to, over time, the current account deficit getting into a better posture; and the things I talked about are the very things that need to be focused on.

The CHAIRMAN. Congressman's time has expired.

The gentlelady from Illinois, Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman; and thank you for being here, Mr. Secretary.

The OECD's Financial Action Task Force has announced 48 recommendations for how countries should structure their efforts to combat money laundering and terrorist finance, and currently our pilot program is under way within the IMF and World Bank that assesses each country's financial sector standards and laws. The G7 recommended making permanent the pilot program, and this is your first testimony on these matters since last year's reform of the intelligence community. So I would like to know how important this World Bank IMF program in the fight against terrorist financing is and what role did the Treasury Department play in the formulation of the standards and their use within the IMF and World Bank?

Secretary SNOW. I am glad to have that question, because we have played a very active role through our representatives, Executive Directors and deputy Executive Director at both of those institutions, and this is something we very much support. We want to see a more robust role for both of those entities in the war against financial terrorism. We think the standards are an awfully important way to go and strengthens our hand in dealing with terrorist finance, and I think the United States yields to nobody in that whole effort. In fact, we yield to nobody on the whole effort on a

global basis to build the world community support for these initiatives. The U.S. has task forces and technical teams all over the world helping build the competencies on terrorist finance that otherwise wouldn't exist.

Mrs. BIGGERT. Well, some have suggested that the FATF may have reached its limits to prescribe standards for fighting the money laundering and terrorist financing and should focus on implementation in the near future. Do you agree with that?

Secretary SNOW. Well, I think both—I think we can still broaden and deepen the effort, but we are at the point where the standards are largely in place. Competency levels have been developed, and the focus has to be implementation. Absolutely. I agree with you.

Mrs. BIGGERT. I understand that a number of regional-style FATF groups have been created and there has been a recent meeting that occurred in the Middle East, North Africa region and the agenda included how to address the link between the Muslim charities and possible terrorist funding as well as trade-based methods for funding the terrorist activities through falsified trade documents. Did the United States participate in these meetings directly or on an observer basis?

Secretary SNOW. I am not sure whether we did directly. Our presence was certainly felt, because we have engaged with all of the countries in the region on that subject. I have held two or three—Dr. Taylor and I have held three or four conferences with the ministers and central bank governors of the region in which the subject of anti-terrorist finance, dealing with charities, dealing with couriers, dealing with bank regulation to get at the problem has been the primary subject of our engagement. So, yes, whether we were there or not our presence was felt because of all these far-reaching engagements we have had on this subject.

Mrs. BIGGERT. What do you think about the assessment the progress that is being made by this type of FATF body?

Secretary SNOW. I think there is good progress. There has clearly been a heightened understanding of the problem, a heightened commitment to it. Many more resources going into it, much higher competency level in going at the problem, but we are not satisfied. There is still a lot to be done, I would grant you that. But the difference between now and two years ago is really night and day in terms of the commitment to the issue.

Mrs. BIGGERT. Do you think there are new tools that the international financial system may need to detect funds that finance terrorist activities?

Secretary SNOW. Yes. I think we have got to continuously adapt as they adapt. They are continuing to change. As we harden up and tighten up in one area, they find routes around it, and we are continuously learning and responding. This is a integrative process, and now E-commerce is becoming a vehicle for the movement of funds. We can never rest.

The CHAIRMAN. Gentlelady's time has expired.

Gentlelady from Wisconsin, Ms. Moore.

Ms. MOORE. Thank you, Mr. Chairman.

I am always stunned that I have the opportunity to ask a question; and thank you, Secretary Snow. It has really been a great

hearing, and I really have appreciated your animation and really engaging on these questions.

My questions relate to your written testimony on the current trade imbalances, and I sort of want to pursue some of the line of questioning that Mrs. Maloney raised with you earlier. Your analysis in your written statements say that—basically, you have said that the economic policies of countries, good and bad, really contribute to the global economy. And one of the things that you said in your testimony is that there is a gap, obviously, in the investment opportunities in the United States and the levels of savings in our economy. I am wondering if there is any connection or tie between the tax cuts that we provided and those beneficiaries not saving or investing in foreign instruments rather than in the United States instruments? Do you have any insight—that is my first question—into whether those tax cuts did or did not contribute to this gap?

Secretary SNOW. Ms. Moore, I don't think the tax cuts had much effect on—they certainly left people with more disposable income.

Ms. MOORE. What did they do with it or didn't do with it?

Secretary SNOW. Left the government with less money and left people with more money. The tax cuts, it seems to me pretty clearly, have helped get the American economy growing faster.

Ms. MOORE. Did they save it?

Secretary SNOW. They clearly didn't save a lot of it, as indicated in our savings rates, but we have much higher growth rates. Those growth rates have given people more disposable income; and some part of that disposable income, given our high propensity to spend, has been spent overseas to purchase imports. And certainly that has contributed to this imbalance. Our faster growth rate versus our trading partners has contributed to this imbalance.

Ms. MOORE. We give tax breaks and then they spent it overseas.

Secretary SNOW. Well, they spent it here and spent some part of it overseas.

Ms. MOORE. You also mentioned during the questions that many of our Members have given on both sides of the aisle that raised important issues—you said, in response to a question about what we could do in those poor countries, that if there were some private sector investment in those poor countries that would obviate this borrow-and-then-we-bail-them-out cycle and borrow-and-bailout cycle. Were you talking about private sector investment from inside those countries or from Americans?

Secretary SNOW. Well, successful economic development requires investments, and it is often led by foreign direct investment, where investors from outside the country bring capital to the country and expertise with it.

Ms. MOORE. Wouldn't it put these same countries in the same predicament? Right now, we are the strongest economy in the world; and perhaps that is the only thing that is keeping us afloat. But isn't our essential problem—I mean, to quote you, you say really, at the most fundamental level, the problem that we are facing is that we have a lot of investment opportunities and very low savings. Is this a formula for failure to say to very, very poor countries who are not developed, just open yourself up to all these foreign investors versus things like grants and loan forgiveness and other

things, to have foreign investors basically come in and put them in a debt situation with their private investments?

Secretary SNOW. What I am talking about, that is where a foreign investor comes in and builds a plant and creates physical assets that invest in some cases in roads or in the textile manufacturing or in agriculture and that will strengthen the economy of that poor country. It will create new jobs, and it will raise their GDP.

On the debts that I was talking about, those are primarily the debts that come from the lending of the World Bank and the other multilateral development banks that was intended to help the countries but has created nonsustainable debt levels. In our view, it is very simple and straightforward. These countries are getting buried in debt, and we want to help them. One way to help them is remove that debt.

The CHAIRMAN. The gentlelady's time has expired.

The gentleman from Illinois.

Mr. MANZULLO. Always good to see you and appreciate your patient attitude towards the Chinese with regard to floating the renminbi. We have talked about this in the past, and you have said it, and correctly so, that you can't move too quickly on it because the Chinese structure was simply not in place to handle a floating currency. In your written testimony on the bottom of page 5 you state: the Chinese are now ready to adopt a more flexible exchange rate. They have sufficiently prepared their financial system to live in a world of greater flexibility and need to take action now.

Members of Congress are grumbling. They are grumbling because now there is another free trade agreement that is being set before us, CAFTA; and there is resistance coming among the free trade circles, which is where I am, that the Administration has to do two things: One, there has to be dramatic decisive action to force the Chinese to float their currency; and, second, that China must be treated as a market economy so that when they subsidize their companies we can get countervailing duties against them.

What do you think about attaching legislation to CAFTA or as a prerequisite to satisfy Members of Congress and I guess to satisfy yourself, Mr. Secretary? Because you have done everything you can. You waited it out. And the Chinese are experts at delaying. They have 6,000 years of recorded history. We have about 225. What can be done to now force the Chinese, because they are ready to float, what can be done to force them to float their currency?

Secretary SNOW. Congressman Manzullo, the decision to float a currency is a sovereign decision. We have had long, intense discussions with the Chinese over a period of time. They have committed to do it. They have taken a lot of steps to put their financial system in place to enable the financial system to function well with the floating exchange rate, with a flexible exchange rate. And having taken all those steps, we are clear—we are telling them directly, you know, you made enough progress here. We commend you on the progress. That progress now should lead to the next step, which is the flexibility.

I don't support, as you know, the legislation that is being talked about that would impose a tariff on everything coming out of China by an amount that is estimated to be the difference between the

current exchange rate and what the exchange rate would be if it floated.

Secretary SNOW. I mean, I know, I am sympathetic to the ideas—

Mr. MANZULLO. Even the author does not support that.

Secretary SNOW. But I am concerned it will not be effective. I want the result that I think you want, and that is flexibility in their currency. I just do not think that is the right way to get it.

Mr. MANZULLO. I agree that tariffs, tariffs will not work. But what are you going to do? I mean, it has got to be in this dynasty. Otherwise, it will just continue the way it is now. That seems to be what they are doing.

I mean, we are at the point where the folks back home are saying, Congressman, how can you even consider another free trade agreement when we are locked into this horrible mess? I mean, what about a Section 301 or what about legislation that would allow the US to bring an action under 301 for the currency imbalance?

What about those remedies?

Secretary SNOW. Well, we have looked, you know, in the past, at the 301 option and did not find it appropriate as a vehicle to deal with the currency, with the currency issue.

Clearly, China is going to have to move here. The time has come, it is overdue.

Mr. MANZULLO. They are not. Their hands are going to be forced so we will have to find a way to do it. I do not expect to have an answer within the next 15 seconds, but I think that is what Congress is really asking for is some solid concrete solution to get it done, and they will appreciate your leadership on that.

Secretary SNOW. Well, thank you, we want to see it done. You know that.

Mr. MANZULLO. Thank you, I yield back.

The CHAIRMAN. The gentleman yields back. The gentleman, the very patient gentleman from California, Mr. Baca.

Mr. BACA. Thank you, Mr. Chairman.

The CHAIRMAN. Please turn your mike on.

Mr. BACA. Thank you very much, Mr. Chairman. Thank you, Mr. Secretary for appearing before us.

As you know, Mr. Chairman, one of the most important things for insuring the health of international financial systems is preserving the soundness of the U.S. economy. Many foreign governments have invested in our bonds, and it is important they continue to be able to have faith in the integrity of our system.

Based on that and based on the opening statements, you indicated that the world economy is in good condition, no recession, no crisis, but yet you continue to indicate that we are at a deficit that is too high, and there needs to be more control on spending, I do agree with you there.

In light of that, it seems like this Administration—we are very much concerned with this Administration's budget. It continues to underestimate the cost of the war that continues to be high, somewhere around \$400 some billion that we spent on the war. Now we are talking about Social Security and privatization.

Before I get into that, you also indicated that we have created about 2.4 million jobs. Well, we do not know what kind of jobs were created and how many jobs were created two or three times, because we could have counted two or three times. We actually have lost about 2 million jobs.

We have lost about 550,000 jobs in outsourcing, so we have lost a lot of jobs. So it makes it very difficult as we look at another trade agreement, see if we can get another trade agreement because we are looking at the President's plan to look at Social Security, privatizing, yet we know that the jobs that are created here pay into the system. Yet if we continue to outsource, we will not have those jobs out here.

I want to hear your opinion in reference to what we should do to make sure the economy grows strong here in the United States, and we do not create jobs outside of the United States, because many of those manufacturers are leaving our areas. Just as Mr. Sanders said earlier, in Vermont, I am faced with the possibility of losing—my District in Ontario—163 jobs from General Electric that may be going overseas. I am very much concerned about this.

Could you please address that?

Secretary SNOW. Well, I would be delighted to. We want to create as many jobs as we can in the United States. I am with you 100 percent. We want to make America the best place to invest. So capital comes in here and—

Mr. BACA. If we do have that, then those people are able to pay into the Social Security system to make it solvent so we would not be in a—you would say in a crisis, you know. We would be in a challenge. That is basically what we are doing now is we are creating a situation by having these jobs leave the United States and not having those jobs that are created to pay into the system.

Secretary SNOW. We have got to keep the American economy capable of generating jobs. That means, in my view, keeping it innovative, keeping it focused on the principles of enterprise that have always been the strength of our country. Rewarding initiative, rewarding risk taking, rewarding innovation and entrepreneurship.

I am confident, if we do all of that, we are going to continue to attract capital, to build innovative businesses and to create lots of jobs. That is our whole history.

Mr. BACA. I hope we do that, because one of the other things that you stated in your opening statement is you indicated that raising—the standard of living has gone up. I am wondering for whom, because there are a lot of people out there that are unemployed right now, that their standard of living has not gone up.

Then when you look at the estate tax and the tax breaks, yes, for them, the standard of living has gone up. But for those middle income and working families and others, they are unemployed and looking for skills and looking for jobs that they do not have here.

Secretary SNOW. Well, let me assure you, we are not satisfied. There are some 3 million additional people working, according to the Bureau of Labor Statistics.

That is good, but we are not satisfied. The unemployment rate has come down to 5.2. That is good, but it can do better.

Mr. BACA. It depends on how we are accounting. If sometimes we are accounting double or triple the same person now having to

work two or three different jobs—because the manufacturers that used to be here, they used to get paid \$25. Now that person has to work two jobs or three jobs, and yet sometimes, I believe we are double counting. Is that so, could it be?

Secretary SNOW. Well, this will be a long discussion if we got into it in any detail, which we can do otherwise. But there are two different surveys, as you know. There is the household survey, and there is the more widely used employment survey called the establishment survey.

The household survey does look at multiple jobs and counts multiple jobs, and the other one does not. So there are some differences in the way the indices, the surveys are conducted.

But basically, I think they both agree that we are creating a lot more jobs than was the case for 3 years ago.

The CHAIRMAN. The gentleman's time has expired.

Mr. BACA. I hope they are in the United States and not outside of the States.

The CHAIRMAN. Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman. It is a privilege to be in your company, Mr. Secretary.

Secretary SNOW. Thank you very much, Congressman.

Mr. GREEN. I represent the Ninth Congressional District in Houston, Texas. To many of my constituents, free trade is not free. Free trade, in fact, is, in their opinion, quite expensive. In their opinion, free trade is costing jobs and is impacting their lives adversely. Free trade is costing about \$61 billion and a trade deficit. That is an expensive proposition.

So when free trade is costing as much as it appears to be costing, to them, it is not fair trade, and that is why that term fair trade has gained momentum. People want to be treated fairly. They do not think they are being treated fairly with reference to our relationship with China.

While we can be patient here and wait for change, I sense a growing impatience among my constituents. I suppose the question becomes, what do we do when flexibility is not demonstrated? How do we manage the relationship when flexibility is not demonstrated?

I have a follow-up, if I may, once I hear the answer.

Secretary SNOW. Well, Mr. Green, I am not satisfied with the pace of progress here. We are disappointed that they have not moved.

I do feel that the best way to get them to move is to pursue this financial diplomacy, if you want to call it that, that we have been engaged in. There are very visible signs that they are moving.

They have taken any number of steps to prepare the way. They put in place a very strong bank regulator. They are taking on the nonperforming loans. They are capitalizing the banks. They are allowing people to take more money out of the country. They are allowing firms that earn profits out of the country to leave it out of the country.

All of these are steps in the right direction, including the transaction they have negotiated with the Chicago Mercantile Exchange to put in a hedging arrangement for their currency. We are going

to continue—let me show you, we are going to continue to press them.

There are a lot of things that we are not happy about, such as intellectual property rights. Trade has got to be a two-way street. The counterfeiting that goes on is terribly unfair, as you are saying.

All of that is on the agenda with the Chinese. We are focusing primarily on the currency side, but others in the Administration are focusing as well on taking the lead on other sides. It has got to be fair, it has got to be a two-way Street. I agree with you.

Mr. GREEN. I will forego the follow up and just make a comment. You indicated earlier that the world economy is in good order and that we are in a sweet spot. But there is something that is unusual about this in that—and I would like to relate this to people right here in this country.

We have this notion that a rising tide raises all boats. Unfortunately, in our country, women still make about \$0.76 for every dollar a man makes, unless you happen to be an African-American woman, and then you make about \$0.66; or you happen to be a Hispanic woman, and you make about \$0.55.

So there are some people who find themselves living in a paradise, but they seem to be strangers in paradise. It is very difficult sometimes to be a stranger in paradise. I would hope that as we focus on all of these means by which the world economy is in a sweet spot that we can do something about a systemic problem right here in our own country.

I do not expect you to solve that problem or to give me a response, to be quite candid with you. I just think that it is good for us to note that in these times of great prosperity that there are some who have stagnated and are not really benefitting to the extent that many others are.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Alabama in the back, clean up.

Mr. DAVIS OF ALABAMA. Thank you, Mr. Chairman.

Let me say, Mr. Secretary, I am the only thing stopping you from getting out the door. I will try to hit on two or three topics with you.

Let me go back for a moment to Mr. Manzullo's line of questions. He asked you—and you talked at length—about the anti-devaluation bill that is pending before the Senate. You responded to that.

I do not remember you responding to his question about the countervailing duties bill. Senator Bayh, as you know is the Senate Democratic lead sponsor in the Senate.

As you probably do not know, I am the lead Democratic sponsor in the House on that measure.

Briefly, is the Administration opposed to legislation that would subject China to the same standards as the market economies?

Secretary SNOW. Congressman, I wish I knew the legislation better. I am not really familiar with this legislation.

Mr. DAVIS OF ALABAMA. Are you opposed to it in principle? If I can summarize it to you. What it does is very basic. It states that, as you no doubt know, market economies, if they subsidize their industries or are deemed to be in violation of the WTO's anti-subsidization rules, they are subject to countervailing duties. Right

now, the nonmarket economies which shine as the most conspicuous are not subject to such duties.

As a matter of theory, is there any reason in terms of fairness or equity or basic economics why the nonmarket should not be subject to the same rules as the markets?

Secretary SNOW. Subsidies, of course, are not good policy.

Mr. DAVIS OF ALABAMA. And more reason why—

Secretary SNOW. Yes, as a general proposition, they are sometimes defended with respect to developing countries on the grounds of, if an industry is—you know, I think even the great Alexander Hamilton defended some protection for domestic industry in the United States for a time as we became a developing country.

Mr. DAVIS OF ALABAMA. Does China fit in the developing country scenario at this point?

Secretary SNOW. They are—they are certainly, that is the terminology that is applied to them in these trade circles. They are a developing, not yet a developed country.

Mr. DAVIS OF ALABAMA. Do they appear to be a country that is hampered and incapable of competing with the rest of the world? Just what do you mean by developing?

Secretary SNOW. Well, it is a very uneven story with China, of course. Some parts of their economy are doing well, and others are still very rudimentary.

Mr. DAVIS OF ALABAMA. Let me try to move you along a little bit, because I am last, and my time is still limited. Does the Administration oppose or support or have any position on the countervailing duty bill right now?

Secretary SNOW. You know, I am going to defer to my colleague, who is responsible for this, Mr. Gutierrez?

Mr. DAVIS OF ALABAMA. Okay. Let me move to the second question to use the time more effectively.

Another thing that you were asked about repeatedly today was the low savings rate.

Secretary SNOW. Right.

Mr. DAVIS OF ALABAMA. There certainly is no dispute on either side of this aisle that we have not been nearly as effective as we want to be in terms of generating savings.

One theory that some economists have, as you know, is that part of the reason why people save so little in this country is because we have an exceptionally generous credit card industry, and the credit card companies are very, very quick to extend credit to high-risk individuals who are not good candidates to pay back the loan and often have to result to more borrowing to pay back the credit when they get credit.

Does it stand to reason that we would do something to improve our savings climate if we made it harder for credit card companies to lend credit to high-risk individuals?

Secretary SNOW. I think we do a lot to deal with that issue. It is an issue, I agree with you. If we would advance financial literacy. And one of the things—

Mr. DAVIS OF ALABAMA. Well, that is a good question—

Secretary SNOW. We have to do is lead this effort on financial literacy.

Mr. DAVIS OF ALABAMA. Let me cut you off for one second, I do not mean to be rude. I just want to make the best use of my time. That is one strategy. I did not ask you to comment on that one.

I will ask you to comment on the particular one I mentioned, which is making it harder for credit card companies to do what they do, which is to target low-income people. You, for example, may be aware they often target people after they file bankruptcy. They target college students. They target a variety of people, and that pushes them away from a savings mentality.

So, short answer—short question, hopefully, short answer, doesn't it stand to reason that it would be good for our economy and would allow us to make some dent in the savings problem if we made it harder for credit card companies to extend credit so generously to high-risk people?

Secretary SNOW. Congressman, I am reluctant to get into that, because I just do not know enough about it. I am fearful that giving a broad answer, yes or no, to a detailed question like that might leave inferences that I am not—create implications for which I am not aware.

Let me think about that, and I will get back to you.

What I do know is that we have a real problem with financial literacy. We need to focus on financial literacy. We have got to make people aware of what happens with compounding interest, when it is in your favor and when it is not in your favor and that a lot of people are taking on credit card debt that they should not take on. I will agree with you on that.

The CHAIRMAN. The gentleman's time has expired.

Let me say to my friend from California.

Ms. WATERS. Thank you very much.

The CHAIRMAN. He has to catch a plane.

Ms. WATERS. I know he has to catch a plane.

I am going to submit my questions to the record for you to answer. I want to know the progress of negotiations and what you are doing to help provide the 100 percent debt cancellation and some information about the IMF and how you see that and how the off-market gold sales are something that you can share information with us about. You do not have to answer.

Secretary SNOW. Thank you.

The CHAIRMAN. Without objection, that would be the case.

Mr. Secretary, we thank you so much. I would make one request. The chair requests that you provide the Committee, for the hearing record, a list of all of the reforms undertaken by China in the last 2 years to prepare for a flexible exchange rate.

Secretary SNOW. We will be delighted to do that, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Secretary, and again, thank you for your appearance.

Secretary SNOW. Thank you very much.

Ms. WATERS. Mr. Chairman?

The CHAIRMAN. The gentlelady from California.

Ms. WATERS. Mr. Chairman, I would ask unanimous consent to enter my statement into the record.

[The prepared statement of Hon. Maxine Waters can be found on page 58 in the appendix.]

The CHAIRMAN. Without objection. Thank you.

The Committee is adjourned.
[Whereupon, at 5:15 p.m., the Committee was adjourned.]

A P P E N D I X

April 19, 2005

**Opening Statement
Chairman Michael G. Oxley
Committee on Financial Services**

**Hearing to receive Testimony of
Secretary of the Treasury, John Snow
April 19, 2005**

Good afternoon, Mr. Secretary, and welcome to the Committee.

I am glad to welcome you here to the Financial Services Committee for another annual testimony on the state of the international financial system.

We meet as the Group of Seven countries strive both to make structural changes identified in the agenda for growth. Global imbalances are global challenges that all parties need to meet in order to safeguard continued economic growth around the world. At the same time, G-7 leaders are considering how best to fund development and manage the IMF's assets.

U.S. leadership in the G-7 has generated innovative approaches for addressing the challenges and opportunities presented by China's growth. I hope that real progress on these issues can be made in time for the G-7 summit this summer.

I note that this is the Secretary's first testimony since Congress passed and the President signed the Intelligence Reform and Terrorism Prevention Act. That Act included a requirement, authored by my colleague, Mrs. Biggert, that this annual testimony include an assessment of international cooperation and coordination from the IMF, World Bank, and other multilateral policymaking bodies in the fight against terrorist finance. I look forward to your testimony on this topic.

Economic resilience and continued growth are critical components to providing peace, stability, and freedom around the world. As President Bush has noted, "economic and political freedom gives hope to millions who are weary of poverty and oppression." As your testimony rightly points out, a five percent expansion in sub-Saharan economies over the next two years would lift nearly 30 million people out of poverty.

One important method for promoting economic development is to foster conditions for more balanced growth worldwide. Stronger economies create more demand, promote economic opportunity and ownership, and provide a foundation for political stability. I look forward to hearing your ideas for how we can support European efforts make the necessary labor and other structural reforms that are so needed.

I continue to support the President's efforts to express America's compassion for the world's most vulnerable people through a wide range of development initiatives. I also support the increase by \$100 million for multilateral development assistance for the International Development Association and the African Development Fund, and the increased proportion of grants.

The U.K.'s Presidency of the G-7 is wisely spent focusing on development issues. I commend our cousins across the Atlantic for their vision, even as I question whether all the proposals make sense. I will be interested to hear your views on the proposed international financing facility.

I expect we will evaluate the IDA and ADF replenishment requests in light of progress made to implement performance-based assessments as well as efforts to increase transparency, anti-corruption programs, and accountability. We need to be sure that development dollars are allocated efficiently and are going to the people who need it most.

I hope that the new President of the World Bank will adopt as a high personal priority continuation and expansion of the Bank's anti-corruption efforts. This could help counterbalance potential bureaucratic backsliding and competitive pressures among other regional MDBs to lower standards.

Regarding proposals to mobilize some of the IMF's gold reserves to fund debt relief, I note that U.S. negotiations to sell IMF gold cannot be conducted without Congressional authorization, starting with this Committee. We have not received such a request and I understand there is no consensus in favor of gold sales within the G-7. Therefore, I assume that no such negotiations are underway.

In the area of trade, liberalization at all levels can be more effective than development assistance in fostering economic growth. Trade is not a zero sum game and all participants benefit from liberalization. I look with cautious optimism at the broader Doha round of negotiations in the WTO as well as efforts within the Group of Twenty to support progress on the global trade agenda. I would urge you, Mr. Secretary, to be actively and personally engaged in helping to move along the financial services negotiations.

Last, but not least, I focus on Europe and the Financial Markets Dialogue. We meet as the U.S. and the E.U. are forging a reinvigorated relationship following the President's successful visit to Europe. The Treasury Department has done an excellent job of leading this informal forum in which regulators from the U.S. and Europe can discuss regulatory differences.

Finally, concern exists that the Treasury Department may not be appropriately staffed internationally. Consequently, I together with Chairman Pryce and Ranking Members Frank and Maloney commissioned a GAO study yesterday to assess Treasury's international staffing structure and whether changes can facilitate the Department's conduct of international economic policy. We at the Committee share with you an interest in ensuring that the Treasury Department has adequate staff and a good structure to meet the strategic economic policy challenges of the 21st century.

Chairman Deborah Pryce
Subcommittee on Domestic and International Monetary Policy,
Trade and Technology
B-304 RHOB

Statement for the Record
Hearing on International Monetary Policy
Secretary John Snow
April 19, 2005

Thank you, Chairman Oxley.

Welcome Secretary Snow and thank you for taking the time to discuss with us the state of the international financial system.

The health of the U.S. and EU economies is inextricably bound together, with trade and cross-border investment flows linking them and their capital markets. The recent historic enlargement of the EU through the accession of 10 new Member States only magnifies the region's importance to the United States. The increasing closeness of the U.S. – EU relationship is underscored in the large trade in financial ideas, talent, technology and capital across the Atlantic. I commend you Mr. Secretary and your staff for opening a dialogue with the EU dedicated specifically to financial services issues and I hope to hear more during this hearing on how the Treasury is working to improve trade in financial services between the US and EU.

Mr. Secretary, as you know, U.S. and international financial regulators have been negotiating new capital requirements for banks in the Basel Committee over the past several years. I am concerned about lack of transparency in this process, and the cooperation among US regulators. I know other Members on this committee share my concern and would appreciate your thoughts on the Basel II process; specifically noting how the US regulators are working together and the competitive impact Basel II will have on banks that do not "opt-in."

The G-7 recently made a political commitment to provide "as much as 100% debt relief," to relieve the debt burdens of the poorest countries in the world, but without providing a view on how this could be funded. In light of the G-7's agenda on development and debt relief for this year, I am hoping you will touch upon recent discussions to have the IMF sell some of its gold stocks and use the anticipated profits to relieve Highly Indebted Poor Countries' debt.

As you recall, the last time this idea was raised was in 1999, with the initial creation of the HIPC program, gold prices plummeted to a 20-year low. News of the G-7's proposal to sell gold from the IMF's stockpile to pay for debt relief sent gold prices down again in October of last year affecting not only U.S. gold-rich states, but also the developing countries that depend on gold for export revenue.

As I am sure you are aware, U.S. law prohibits the Treasury from engaging in negotiations on this matter without consultation and approval from Congress. As the United States is the second largest producer of gold in the world, any proposal to sell IMF Gold, will provoke a long congressional debate as it did five years ago. I'll be following this issue closely, as I hope you will as well.

I hope to discuss with you further the proposed sale of IMF Gold and am particularly interested in hearing you speak on what you believe is the U.S. role in the prevention of such a sale.

I thank the Secretary for his appearance today and look forward to his testimony.

With that, I yield back the balance of my time.

**Hearing on International Financial Institutions
Committee on Financial Services
Rep. Maxine Waters
Statement for the Record
April 19, 2005**

Thank you, Chairman Oxley, for organizing this hearing on the state of the global financial system and international financial institutions.

This past weekend, the G-7 Finance Ministers, the IMF and the World Bank squandered yet another opportunity to end the cycle of debt that afflicts the world's poorest countries. While the United States and other G-7 members have been discussing the need for 100% debt cancellation for these countries for several months, various newspaper reports over the weekend suggested that no progress towards this important goal was made at the weekend meetings.

I am especially concerned by a statement in a press release issued by the Treasury Department after this weekend's meetings that said, "We are not persuaded by arguments for IMF debt relief, and we do not believe market or 'off-market' gold sales are necessary or warranted." Prior statements by Treasury officials suggested that the Administration supported debt cancellation, but had not reached agreement with other G-7 members regarding how debt cancellation should be financed. Has the Administration changed its position? Secretary Snow must clarify whether the Administration continues to support full debt cancellation, and he must explain the Administration's position on how to achieve this goal.

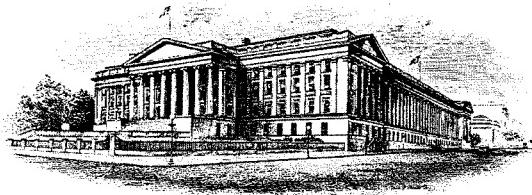
Impoverished countries will never be able to eradicate poverty as long as they must continue to make payments on old loans that they never will be able to repay. Money that impoverished countries must send to creditors such as the IMF and the World Bank is money that is not spent on pressing social needs like health care, education and clean water. The people of impoverished countries need a chance; they need full debt cancellation.

Many poor countries are being forced to pay debts that resulted from loans to corrupt and brutal dictators, who used the money to enrich themselves or repress their populations. Nigeria's debt was incurred under the dictatorship of Sani Abacha. The Philippines' debt was incurred by Ferdinand Marcos. Nicaragua's debt was incurred during the Somoza dictatorship, and South Africa's debt is the result of decades of white minority rule under *apartheid*. These loans did not benefit the vast majority of the people in the countries that received them, and it is unjust and immoral to expect them to pay back the debts.

On March 3, I reintroduced *the JUBILEE Act*, now H.R. 1130, a bipartisan bill to cancel completely the multilateral debts of fifty of the world's poorest countries. The *JUBILEE Act* would free poor countries from the debt burden and allow them to invest their resources in health care, education, poverty reduction and other programs that meet human needs. The *JUBILEE Act* now has fifty-five cosponsors, including several members of the Financial Services Committee.

Last Friday, I sent a letter to Treasury Secretary John Snow urging him to negotiate an agreement to provide 100% multilateral debt cancellation to poor countries during the weekend meetings. In sending this letter, I was joined by Representatives James Leach, the former Chairman of the Banking Committee; Barney Frank, the Ranking Member of the Financial Services Committee; Spencer Bachus, the former Chairman of the Subcommittee on Domestic and International Monetary Policy; and Carolyn Maloney, the Ranking Member of the Subcommittee on Domestic and International Monetary Policy.

I hope that Secretary Snow will clarify the Administration's position on debt cancellation during his testimony this afternoon. I especially look forward to hearing him explain the role he played in discussions of debt cancellation and the progress that was made towards an agreement to provide debt cancellation at last weekend's meetings.



**DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS**

EMBARGOED UNTIL 3:00 pm

Contact: Rob Nichols
or Tony Fratto
at 202-622-2910

**The State of the International Economy
Testimony Before the House Committee on Financial Services**
John W. Snow
Secretary of the Treasury
April 19, 2005

Thank you, Chairman Oxley, Ranking Member Frank, and other members of the Committee.

Let me begin with the goals of the Bush Administration's international economic policy. They are threefold:

- *Increasing economic growth*, because strong growth creates jobs, raises incomes, and reduces poverty over time,
- *Increasing economic stability*, because financial crises and recessions cause hardship and suffering, and impede economic progress,
- *Advancing U.S. foreign policy*—in coordination with our international political and security policy—because this will make America and the world safer and more secure.

Our international economic agenda includes opening markets and integrating the global economy, and the Treasury has a key role in formulating and implementing this agenda. That is why the Congress has required this annual testimony by the Secretary of the Treasury, and it is a pleasure to be here again today.

How are we doing in achieving these goals? I am happy to report that as a whole the global economy is performing very well:

- Global economic growth is as strong as it has been in thirty years, and, with inflation historically low, the expansion is expected to continue this year and beyond.
- The news about economic stability is equally good: there are no major recessions, no financial crises, and interest rate spreads, which measure risk, are historically low.

- And on the foreign policy front, our economic efforts are achieving important successes in combating terrorist financing, in the financial reconstruction in countries such as Afghanistan and Iraq, and in promoting economic freedom in the Broader Middle East and North Africa and other regions.

What are the reasons for this excellent economic performance? In my view good economic policies in the United States and other countries deserve much of the credit. To show this, I will highlight important events in three areas: (1) the developed economies, (2) the emerging market economies, and (3) the international financial system as a whole. In doing so it becomes clear that, despite the remarkable policy accomplishments of the last several years, this is no time to be complacent. There are challenges to address if we are to continue to see more growth, stability, and economic freedom around the world.

1. The Developed Economies

Among the large industrial economies, the United States is leading the way. Economic growth was 4.4 percent last year, the strongest in five years. The addition of 2.4 million jobs in the last twelve months alone attests to the continuing recovery from the slowdown of 2000-2001.

I believe that the first and most important part of an international economic policy is good policy at home, and here we have been successful. Well-timed fiscal policy changes—including the tax cuts of 2001 and 2003—and well-timed monetary policy changes restored stability, made the recession one of the shortest and mildest in United States history, and created the right incentives for strengthening the private sector led expansion. With inflation low, the expansion is expected to continue, even though oil prices remain a drag on the rate on economic growth. To make economic growth stronger, we must reduce the budget deficit, reform Social Security and the tax system, reduce the regulatory burden on business, and pass energy legislation—all high priorities of President Bush in his second term. Our efforts to reduce the fiscal deficit will be important for promoting greater stability of the international financial system.

The second largest economy, Japan, has also shown important improvements. The 1990s in Japan is frequently called the lost decade because of near zero economic growth, persistent deflation, and instability. Thus it is good news that Japan grew at about 2-1/2 percent on average in 2003 and 2004, and, despite the pause in the later part of last year, Japan's economic recovery appears to be continuing. As in the United States policy changes in Japan have been an important factor, including a monetary policy aimed at ending deflation and a large reduction in non-performing loans. Despite these improvements, however, Japan's longer-term economic growth is being held back by structural rigidities, which must be addressed if Japan is to reach its full potential.

Unfortunately, economic recovery has not yet taken hold in the Euro area as a whole. Economic growth in the Euro area was less than 2 percent last year, close to the low average of the last ten years. While growth remains strong in the U.K. and the Scandinavian countries, it is very low in

Germany and Italy. These important industrial economies confront the task of generating economic growth in the face of changing demographics and structural impediments.

Current Account Imbalances

With the United States growing more rapidly than other industrial countries, exports have grown less rapidly than imports, and our *current account deficit* has therefore risen over the years. In 1990 it was 1 percent of GDP. By 2000 it had increased to 4 percent. And in 2004 it was about 6 percent. At its most fundamental level, the current account deficit reflects the excess of investment opportunities in the United States over the level of savings in our economy. Reducing the budget deficit in the United States—which, as I said, is a very high priority—will help reduce the current account deficit by reducing the gap between investment and saving. But reducing the *growth deficit* between the United States and other countries is also essential. And this brings me to our G7 Agenda for Growth initiative.

The G7 Agenda for Growth

From the start of his Administration, President Bush called for close economic engagement with our allies, emphasizing candid discussions based on mutual respect and cooperation rather than antagonism. Our successful economic engagement with Japan is an example. From the first Camp David meeting between President Bush and Prime Minister Koizumi in June 2001 to my frequent discussions with Finance Minister Tanigaki, we have discussed the key issues such as restoring health to the Japanese banking system and maintaining a macroeconomic policy stance to support Japanese growth and end deflation.

With the G-7 Agenda for Growth we brought this approach to all G7 industrial countries. The goal, of course, is increased economic growth among the G7, especially those where growth is lagging. The Agenda for Growth focuses on structural reforms needed to increase flexibility, raise productivity, and bolster job creation. This initiative is proving very fruitful. It has permanently expanded the traditional focus of the G7 beyond monetary and fiscal policies to supply-side policies. During the U.S. chairmanship last year, we delved into key areas for reform each time we met—including tax reform, labor market reform, and health care reform. At our final meeting in 2004, we agreed to make supply-side, structural reform issues a regular focus of the G7 meetings. And indeed this has continued as planned under the UK chairmanship.

Beyond the Agenda for Growth

As the Agenda for Growth has taken hold within the G-7, we have sought to extend the pro-growth focus to other multilateral fora. For example, a group of finance and central bank officials that Treasury Under Secretary for International Affairs John Taylor chairs at the OECD has significantly shifted its emphasis to pro-growth supply-side policies and their impact on the current account. Last year the G20 endorsed its analogous “G20 Accord for Sustained Growth”. And to help understand the divergence between U.S. and European productivity growth, the Treasury staff has been engaging with their counterparts at European Commission Presidency.

I believe that change is underway. Germany, for example, recently implemented labor market reforms that provide incentives for the unemployed to return to work. Italy passed a pension reform law in July, raising the retirement age. France has relaxed the 35-hour workweek restriction. The Japanese are working on privatizing mail delivery and its huge postal financial institutions.

These are important achievements, but there is much more to do. Structural reform is difficult. Supply side policies take time to work. But as has been clearly demonstrated in Ireland, they work amazingly well. Last November I met in Warsaw with the Finance Ministers of Poland, Hungary, the Czech Republic, and Slovakia. I was greatly impressed with the speed and depth of their structural reforms, from lowering marginal tax rates to reducing barriers to investment. I am hopeful that these new members to the European Union will be a helpful force for change for the industrial countries, and our engagement with the EU will reflect that hope.

2. The Emerging Market Countries

As we all remember, the 1990s produced a series of damaging financial crises in emerging markets—from Mexico, to East Asia, to Russia, to Brazil. These crises rolled back hard-won economic gains, created profound social disruptions, and left many asking whether the international financial system was a source of instability rather than stability.

The most notable feature of emerging markets today is strong economic growth and the absence of financial crises. Economic growth in Latin America was 6 percent last year. In emerging market Asia it was 7-1/2 percent. In emerging market Europe it was 6-1/2 percent. In South Africa it was nearly 4 percent. Capital flows to emerging markets are again rising following the sudden stop after the Russia crisis in 1998.

Improved Policies and the Role of the United States

In my view these positive outcomes are primarily the result of better economic policies in emerging market countries themselves. Many countries have improved their fiscal policies and strengthened financial supervision. Many have adopted monetary policies that focus on price stability, and have moved from unsustainable fixed exchange rate pegs to flexible exchange rates, or have joined currency unions, or have adopted another country's currency. As a result emerging market inflation has been cut dramatically.

The United States has helped by assisting countries that are pursuing good policies. In fact, when the Bush Administration came into office, there was an urgent need for a comprehensive strategy to promote greater economic stability in emerging markets. This meant not only creating a policy environment that made financial crises less likely, but also setting out to ensure that international assistance, including from the International Monetary Fund (which I discuss later), was used to support countries with good policies, rather than provided in large amounts to countries with flawed policies. And we created new forms of U.S. engagement—such as the Group for Growth with Brazil and the Partnership for Prosperity with Mexico—to share

experiences on how to tackle impediments to higher economic growth.

For example, when Brazil neared a full-blown financial crisis during its election in 2002, the United States supported a loan from the International Monetary Fund (IMF) to bolster the government's sound fiscal program, which was supported by the major candidates in the election. Then, when President Lula won the election and his government strengthened the fiscal program, risk spreads fell sharply. Brazil's economy grew more rapidly last year than it has in ten years.

At the same time, the Administration acted quickly to head off the spread of crises. For example, when Uruguay experienced a bank run sparked by its neighbor Argentina's crisis, the United States mobilized an assistance package that included a \$1.5 billion five-day bridge loan from the Exchange Stabilization Fund to a loan from the IMF to support a plan to back dollar deposits in the banking system. The strategy enabled Uruguay to end the bank run, restore economic growth, and repay the loan in four days.

Financial support worked in Brazil and Uruguay because it was used to bolster good policies. Large amounts of international assistance—such as from the IMF—cannot buy success or avoid crises in countries with poor economic policies. Too often in the past large assistance packages simply underwrote flawed economic policies and artificially shielded investors from reckless risks until it was too late to avoid a crisis.

China, the Exchange Rate, and the G7

Reform of the currency exchange regime in China is one of the highest priorities for our international economic policy. While many large emerging market countries have moved to more flexible exchange regimes, China has maintained an exchange rate peg for over a decade. This impairs adjustment throughout the international financial system and prevents China from using its monetary policy to control inflation as other central banks in the world do.

Along with our G7 partners we have urged China to move to a flexible exchange rate. We take this issue very seriously and have devoted considerable time and attention - at all levels - to working with the Chinese to prepare them for a change. During the past year we have seen progress. A very important development was when Chinese officials met with the G7 Finance Ministers and Central Bank Governors for the first time, and this has continued this year. Engagement with China contributes to global economic stability because of the size of China's economy, and its rapid growth means that it is now an essential participant in the international financial system.

China has not only indicated that it will introduce more flexibility, it has taken the practical steps needed to do so. As members of the G7 have recognized, the time has now come for China to introduce flexibility into its exchange rate. The Chinese are now ready to adopt a more flexible exchange rate, they have sufficiently prepared their financial system to live in a world of greater flexibility and need to take action now.

Economic Freedom in the Broader Middle East and North Africa

Another historically significant new engagement on economic policy has been among the countries of the Broader Middle East, North Africa, and the G8. In the economic sphere this new engagement began in September 2003 at a meeting I chaired in Dubai; we have met four additional times since that time, most recently last weekend in Washington.

This engagement brings together the finance ministers from Morocco to Pakistan, including Turkey, Afghanistan, and Iraq. Our discussions are about their home-grown economic reforms and how the G8 can help. The engagement has already spanned several initiatives, including a new IFC small business facility for the region. By joining with the foreign ministers as we did in the Forum for the Future meeting in Morocco, we hope to exploit the synergy between economic freedom and political freedom that we are seeing in the region.

3. Supporting Poverty-Reduction and Economic Growth in Developing Countries

The Bush Administration's approach to developing countries is based on the principle that good economic policy in the countries is a prerequisite for economic growth and poverty reduction, and that we should work with countries to develop their policies. Official development assistance can be far more effective within such a good policy environment, and indeed it has frequently been wasted when such a policy environment is not in place.

Improving the overall investment climate is particularly important for promoting private sector development and job creation, and access to finance for small businesses is an important component of our development policy.

Based on this principle the Bush Administration launched several initiatives including our reform efforts in the World Bank (which I discuss below) and the Millennium Challenge Account, which will provide development assistance to countries that follow policies that lead to economic growth. The United States has nearly doubled development assistance since 2000. This increase -- which has raised our development assistance by about \$10 billion annually -- represents roughly one-third of the increase in aid from all donor countries combined. U.S. annual assistance to sub-Saharan African countries alone has more than tripled since 2000, with over 30 sub-Saharan countries receiving increases of greater than 50 percent.

These new initiatives, combined with our existing activities, will further promote greater economic growth in developing countries. Given the truly astounding power of growth to reduce poverty, we remain fixated on promoting it. If sub-Saharan African economies expanded by 5 percent in 2005 and 2006, then nearly 30 million people would be lifted out of poverty. The Bush Administration will continue to work vigorously to achieve such ambitious results.

There have been important success stories where poor economies such as India and China have developed into fast growing emerging market countries, but many poor countries have failed to achieve sufficient growth on a sustained basis to lift their people out of poverty. For instance, in

the 1990s sub-Saharan African economies grew by only about 2 percent annually, which is less than population growth, so per capita income declined.

Fortunately, during the last two years economic growth has picked up in many of the poorest countries. For example, in sub-Saharan Africa, growth is now estimated to have been about 4-1/2 percent in 2004. This increase clearly reflects the strong world economy overall, but it also is due to some improvements in economic policy especially greater inflation control in many countries. These higher rates of economic growth are raising per capita incomes and bringing tens of millions of people out of poverty in the poorest countries each year. But there are still billions in poverty and economic growth has to be increased further and be sustained if poverty is to be reduced significantly.

4. The International Financial System and Institutions

So far I have focused on the importance of economic policies undertaken by governments relating mainly to their own countries. Another important part of international policy relates to the international financial system and the international financial institutions. During the first term of the Bush Administration, important reforms were achieved at the IMF, the World Bank, and the other Multilateral Development Banks on which I serve as Governor. And we have made progress in the international financial services and tax areas. These changes are already being implemented and are factor in improved economic performance. And one of the key parts of U.S. foreign policy is our work on combating terrorist financing and supporting reconstruction efforts in Afghanistan, Iraq, and the Palestine Authority.

Reforms at the International Monetary Fund

These reforms set out to *clarify the limits on exceptional access* to IMF lending and to focus IMF programs and conditions on core macroeconomic areas of expertise. These reforms are now in place. Requests for exceptional access now face new procedures, including a higher burden of proof in the form of a special report that documents how IMF resources will support strong policies. The IMF's work—both with respect to its lending programs and surveillance—is more tightly focused and it now relies on more robust analytical tools.

A closely related achievement in the area of crisis prevention and resolution was the Administration's initiative to make the process of restructuring sovereign bonds more orderly through the use of *collective action clauses* (CACs) so that restructurings are less disruptive and more predictable. One year after the launch of this initiative, Mexico became the first country to include CACs in its New York-law governed bonds. Brazil, Korea, South Africa, and Turkey soon followed, as inclusion of CACs quickly became standard market practice.

Reforms at the World Bank and other Multilateral Development Banks (MDBs)

The MDBs serve a critical role in promoting global economic growth and stability, especially in countries and regions where poverty is most acute. From the outset, the Bush Administration has

pursued an aggressive reform agenda in an effort to maximize the MDBs' effectiveness and achieve better results on the ground. These institutions were found by many to be lacking in: measurable results; institutional transparency and accountability; promotion of private sector-led growth; and lending policies that reflected debt sustainability problems in poor countries. As a result of recent reforms, considerable progress has been achieved in measuring results, increasing grants, focusing on private-sector led growth, fighting corruption, and improving transparency and accountability.

In 2001, President Bush called on the MDBs to provide 50 percent of their assistance to the poorest countries in the form of grants. Due to strong U.S. leadership in replenishment negotiations, IDA and the African Development Fund (AfDF) will provide approximately 45 percent of their assistance to the poorest countries in the form of grants. In addition, the Asian Development Fund (AsDF) agreed in 2004 to institute a 30 percent grants program for the poorest countries in Asia. Before President Bush's initiative, nearly all MDB assistance was provided as loans. These landmark achievements represent a crucial step toward ending the lend-and-forgive approach to multilateral assistance and ensuring long-term debt sustainability.

Because of its success in reforming the institutions to deliver assistance more effectively, the Bush Administration was able to justify a reversal of the trend in the 1990s of declining U.S. contributions to the MDBs. Displaying our strong commitment to these important institutions – based on their commitment to reform – during the Bush Administration the U.S. has delivered double-digit increases in funding for IDA, the AfDF and the AsDF, which provide concessional resources to the world's poorest countries.

Further Reforms at the IMF and World Bank

More also needs to be done to ensure that the IMF and World Bank are positioned to assist countries in taking on the economic challenges they face in the 21st century. The United States, in partnership with its G-7 partners and others, has called for a *Strategic Review* of the Bretton Woods institutions to identify the changes needed to make these organizations more responsive, relevant, and helpful to their members. The Bush Administration is committed to seeing this review through and working with the managements of the IMF and World Bank to implement the required reforms.

A bold debt proposal. The shift to greater use of grant financing will reduce unsustainable debt burdens over the long-term. However, debt will continue to act as a constraint on economic growth in the interim. To address this problem, the Bush Administration has put forth a bold debt proposal that would relieve the debt burdens of poor countries without additional cost. The proposal calls for immediate action to provide up to 100 percent relief on IDA and AfDF loans to the Heavily Indebted Poor Countries (HIPC). These actions, combined with the new increases in grants going forward, will put these poor countries on a sustainable path.

A new non-borrowing program. We are also focusing on how the IMF's work in the poorest countries can be more effective. We have proposed a new non-borrowing program for countries that don't need IMF loans but still can benefit from their IMF's macroeconomic policy advice.

Economic needs of the low-income countries are vast; we believe the IMF can play a constructive role in poor countries primarily through surveillance and policy advice and, when needed for balance of payments purposes, financial assistance. Last weekend, the G-7 Finance Ministers expressed their backing for the creation of a non-borrowing program.

These additional reforms will further the division of labor and exploit the comparative advantage of the IMF and the World Bank, with the IMF focusing on monetary, fiscal, exchange rate, and banking supervision issues, and the World Bank focusing on economic development.

International Trade, Financial Services, and Investment

Completion of the Doha Development Agenda is vital to spurring global economic growth, stability, and is an important part of U.S. foreign policy. As part of the Doha Agenda the United States has proposed the elimination of all global tariffs on consumer and industrial goods by 2015 and substantial cuts in farm tariffs and trade distorting subsidies. Trade liberalization on such a grand scale would deliver benefits of roughly \$500 billion annually to the world's poor. This is more than double the size of current official development assistance flows to developing countries.

The Treasury has a particular responsibility in the financial services talks, which are an integral part of the broader Doha negotiation. We are working to draw greater attention to the services component of the Doha discussions and with other finance ministries on the financial services issues in particular.

Treasury is also active in the progress on free trade agreements (FTAs). The FTAs with Chile, Singapore and Australia entered into force in the past year, and we have concluded FTAs with Central America/Dominican Republic, Morocco, and Bahrain. In addition to liberalizing trade in goods and services, these FTAs provide protection for the free flow of capital, so that emerging markets can attract the funds they need to expand the productive potential of their economies. We plan to advance our negotiations on additional free trade agreements in Africa (Southern African Customs Union), Asia (Thailand), Latin America (Andean countries, Panama, Free Trade Area of the Americas), and the Middle East (United Arab Emirates, Oman).

Financial Regulatory Talks Between the United States, Japan, and the Europe

For the past three years, the United States and the European Commission have been discussing a range of financial regulatory issues. The agenda has included Europe's Financial Services Action Plan, the Sarbanes Oxley Act, the Basel II Capital Accord, and convergence of accounting standards. International issues arise because the United States and the European Union have different legal, cultural, and historical traditions. Actions by each may have unintended spillover effects for the other, which our discussions helped to manage. For similar reasons, we have also conducted annual meetings between Japanese and American financial regulators.

Progress on International Tax Treaties

Treasury has been very active pursuing tax treaties in the Bush Administration. This past year we fulfilled another long-standing goal with the conclusion of a new, modern tax treaty with Japan that entered into force on March 30, 2004. The new treaty provides for significantly reduced withholding rates on cross-border payments of dividends, interest and royalties as well as modernizing a number of other rules. The new treaty significantly reduced existing tax barriers to investment and trade in both directions, enhancing the global competitiveness of our businesses and creating new opportunities for international trade and investment.

The Global Fight Against Terrorist Financing

Since September 11, 2001 we have accomplished much in our global fight to disrupt the flow of funds that support terror – a critical component of the overall effort to keep America safe. Worldwide efforts have shut down channels terrorists and their sympathizers depended on to transfer funds, led to the capturing or killing of key terrorist facilitators and deterred donors from supporting al Qaida and other like-minded terrorist groups. We continue to work with our G7 and other international partners to coordinate these efforts. This past year Treasury was pleased to welcome Under Secretary Stuart Levey who oversees our new Office of Terrorism and Financial Intelligence, which is focused on safeguarding the financial system against illicit use and combating rogue nations, terrorist facilitators, money launderers, drug kingpins, and other national security threats.

* * *

Mr. Chairman, I think you can see we have accomplished much in international economic policy during the first term of the Bush Administration from reform of the international financial institutions, to a major increase in development assistance, to new forms of cooperation with our allies. We are pleased that the world economy is performing so well, and that global economic growth and stability have both increased so much. But as I have indicated, we have an ambitious agenda for the second term. I look forward to working with your committee and would be happy to answer any questions.

Questions on Debt Cancellation

**Hearing on International Financial Institutions
Committee on Financial Services
Rep. Maxine Waters
April 19, 2005**

This past weekend, the G-7 Finance Ministers, the IMF and the World Bank squandered yet another opportunity to end the cycle of debt that afflicts the world's poorest countries. While the United States and other G-7 members have been discussing the need for 100% debt cancellation for these countries for several months, various newspaper reports over the weekend suggested that no progress towards this important goal was made at the weekend meetings.

On March 3, I reintroduced *the JUBILEE Act*, now H.R. 1130, a bipartisan bill to cancel completely the multilateral debts of fifty of the world's poorest countries. The *JUBILEE Act* would free poor countries from the debt burden and allow them to invest their resources in health care, education, poverty reduction and other programs that meet human needs. The *JUBILEE Act* now has fifty-five cosponsors, including several members of the Financial Services Committee.

Mr. Secretary, last Friday, I sent you a letter urging you to negotiate an agreement to provide 100% multilateral debt cancellation to poor countries during the weekend meetings. In sending this letter, I was joined by Representatives James Leach, the former Chairman of the Banking Committee; Barney Frank, the Ranking Member of the Financial Services Committee; Spencer Bachus, the former Chairman of the Subcommittee on Domestic and International Monetary Policy; and Carolyn Maloney, the Ranking Member of the Subcommittee on Domestic and International Monetary Policy.

I am very interested to know the status of debt cancellation negotiations, so please answer the following questions.

Question 1

How much progress was made towards an agreement to provide 100% debt cancellation to poor countries at last weekend's meetings? Does full debt cancellation remain the Administration's goal? What issues still need to be resolved before such an agreement can be reached? What are the chances that such an agreement will be reached prior to or during the upcoming G-8 Summit Meeting in Scotland in July?

Question 2

I am especially concerned by a statement in a press release issued by the Treasury Department after this weekend's meetings that said, "We are not persuaded by arguments for IMF debt relief, and we do not believe market or 'off-market' gold sales are necessary or warranted." Prior statements by Treasury officials suggested that the Administration supported debt cancellation but had not reached agreement with other G-7 members regarding how debt cancellation should be financed.

Has the Administration changed its position? Please clarify. Does the Administration continue to support full debt cancellation? If so, how do you propose to achieve this goal? If not, why not?

Question 3

Several ways to finance debt cancellation have been proposed. Last September, the Debt and Development Coalition of Ireland released a report, "The IMF, gold sales and multilateral debt cancellation," that concluded that the IMF could generate up to \$37 billion by combining the uncommitted principal from gold revaluations carried out from 1999-2000 with the revenues from gold sales, without causing an adverse impact on the international gold market. The Jubilee USA Network has argued that the IMF can responsibly sell gold and raise more than \$35 billion to finance debt cancellation, and the World Bank can mobilize at least \$17 billion in accumulated and future profits for debt cancellation. The Jubilee USA Network has also suggested that the resources of the IMF's Poverty Reduction and Growth Facility (PRGF), which frequently imposes harmful economic conditions on developing countries, could be used to finance debt cancellation.

What is Treasury's view of the use of IMF gold sales, World Bank profits and PRGF resources for the financing of debt cancellation? What financing mechanisms for debt cancellation has Treasury discussed with other G-7 members? Do you have any other thoughts or proposals as to how full debt cancellation can be financed?

**QUESTIONS FOR THE RECORD
SECRETARY JOHN W. SNOW
HOUSE COMMITTEE ON FINANCIAL SERVICES
APRIL 19, 2005**

A. REP. MAXINE WATERS QFRS

Question 1:

How much progress was made towards an agreement to provide 100% debt cancellation to poor countries at last weekend's meetings? Does full debt cancellation remain the Administration's goal? What issues still need to be resolved before such an agreement can be reached? What are the chances that such an agreement will be reached prior to or during the upcoming G-8 Summit Meeting in Scotland in July?

Answer:

On June 11, 2005, G-8 Finance Ministers agreed to the debt relief plan outlined by President Bush and Prime Minister Blair. As Treasury Secretary John Snow stated, "President Bush's commitment to lift the crushing debt burden on the world's poorest countries has been achieved. This is an achievement of historic proportions." The G-8 Agreement calls for 100 percent cancellation of debt obligations owed to the World Bank (IDA), African Development Bank (AfDF), and International Monetary Fund by countries eligible for the Heavily Indebted Poor Countries (HIPC) Initiative.¹ This action will conclusively end the destabilizing lend-and-forgive approach to development assistance in low-income countries. Furthermore, the removal of unsustainable debt combined with additional development resources – largely provided on grant terms – will deliver significant support for countries' efforts to reach their development goals.

Question 2:

Has the Administration changed its position [regarding IMF debt relief]? Does the Administration continue to support full debt cancellation? If so, how do you propose to achieve this goal?

Answer:

The plan agreed to by the G-8 Finance Ministers includes 100% IMF relief.

¹ The following countries would be eligible immediately: Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, and Zambia. The remaining HIPCs that have unsustainable debt burdens will also become eligible as they reach the HIPC Completion Point.

Question 3:

What is Treasury's view of the use of IMF gold sales, World Bank profits and PRGF resources for the financing of debt cancellation? What financing mechanisms for debt cancellation has Treasury discussed with other G-7 members? Do you have any other thoughts or proposals as to how full debt cancellation can be financed?

Answer:

The U.S. debt relief proposal achieves 100% relief without a sale of IMF gold. The plan also does not reduce resources required to continue PRGF lending in the future. The debt deal also provides 100 percent cancellation of IDA and AfDF claims immediately without reducing net assistance to recipient countries.

B. REP. SHERMAN'S QFR - PART 1 -- WORLD BANK LENDING TO IRAN

The U.S. government has consistently and vigorously opposed all World Bank lending to Iran. Iran is an IBRD-only borrower, meaning that it receives market rate loans that are funded by World Bank market borrowings. As such, Iran receives none of the funds the Congress appropriates annually to IDA, which provides concessional resources to the world's poorest countries, including countries that use World Bank funds to combat HIV/AIDS. Withholding U.S. funding for IDA because of World Bank engagement with Iran would unfairly penalize these poorest countries and would have no effect on Iran's borrowing from the Bank. It would also reduce U.S influence in both institutions and undermine U.S. leadership on key reform initiatives.

C. REP. SHERMAN'S QFR - PART 2 - CHINA CURRENCY MANIPULATION|

The Bush Administration, led by the Treasury Department, has been working intensively over the past year and half to move China to a more flexible, market-based exchange rate as soon as possible. This has involved frequent, high-level consultations with senior Chinese officials. The Administration has also mobilized our G-7 partners, other East Asian nations, the IMF and the Asian Development Bank to make clear that this is an issue of multilateral importance. Finally, we have had an intensive program of technical assistance aimed at overcoming the obstacles China sees to adopting a more flexible, market-based exchange rate regime. Treasury's technical cooperation program has been highly successful in helping China address shortcomings in its banking system, such as poorly performing loans, and understand how to develop and regulate a foreign exchange derivatives market, and improve banks' foreign exchange risk management practices.

The Chinese authorities in turn have undertaken a number of significant steps to prepare its financial infrastructure for a change to a more flexible currency regime with wider fluctuations in the value of its currency. China is now ready and should move on its

exchange rate without delay in a manner and magnitude that is sufficiently reflective of underlying market conditions.

Treasury has taken a number of steps recently to expedite the process of China moving to adopt a more flexible, market-based currency. In early May, Secretary Snow appointed a Special Emissary on China, Olin Wethington. The appointment of Mr. Wethington, who will be responsible for direct and frequent contact with Chinese leaders and key decision-makers on issues related to exchange rates, seeks to continue and intensify a constructive dialogue with China on this extremely important matter during this critical juncture in U.S.-China economic relations.

In addition, in the recent Foreign Exchange Report submitted to Congress, Treasury emphasized that China's rigid currency regime has become highly distortionary and that it poses risks to the health of the Chinese economy, such as sowing the seeds for excess liquidity creation, asset price inflation, large speculative capital flows and overinvestment. Failure to move to a more flexible regime risks economic disruption and dislocation in China and in the larger global trading system. The Treasury report concluded that if current trends continue without substantial alteration, China's policies will likely meet the technical requirements of the statute for designation in a future report. Finally, Treasury continues to pursue high-level discussions with the world's major trading nations on how best to address imbalances in the global economy and, in particular, to urge support for exchange rate flexibility, especially in emerging Asian economies, notably China.

D. CHAIRMAN OXLEY'S QFR - CHINA REFORMS

Recent Measures to Support a Market-based, Flexible Exchange Rate

During a period of intensive engagement by senior USG officials, together with Treasury's ongoing technical dialogue, China has undertaken a number of significant measures to facilitate transition to a flexible, market-based exchange rate regime. China has reduced barriers to capital flows, deepening markets involving foreign currency transactions. It has worked to strengthen its banks and bank supervision, and to prepare these institutions for exchange rate flexibility. China has taken steps to develop financial products and markets to support foreign exchange trading, hedging of exchange rate risk, bond financing in local currency, and more market-oriented monetary policy tools.

Capital Account Liberalization

An important part of China's strategy to prepare for a market-based exchange rate is to expand capital flow transactions in order to increase the depth and liquidity of foreign exchange markets, making them more efficient at transmitting price signals.

- ✓ In February 2005, China eliminated the surrender requirement for certain commercial firms, who can now retain 100% of their export earnings. Exporters can now exchange export receipts with any authorized bank, rather than just the central bank.

This helps create an inter-bank foreign currency market. China also relaxed other rules on offshore investment.

- ✓ In December 2004, China increased the amount of foreign currency that travelers can take out of the country.
- ✓ In November 2004, China permitted Chinese emigrants to transfer assets overseas and Chinese students to take more money abroad to pay for living expenses.
- ✓ In August 2004, China authorized domestic insurance companies to invest up to 80 percent of their current foreign currency holdings in overseas debt and money markets, effective immediately.
- ✓ In July 2004, China allowed its national social security fund to invest in overseas capital markets.
- ✓ Since May 2004, all enterprises authorized to conduct current account transactions may retain foreign exchange revenue equivalent to 50 percent of their foreign exchange export earnings (up from 20 percent).
- ✓ Since 2003, China introduced policies to encourage foreign direct investment (FDI) outflows, including decentralization of approval authority for outward FDI and streamlining regulation for FDI approval.
- ✓ In 2003, the limit was raised on foreign currency allowed to Chinese travelers and declaration procedures were simplified.

As a result, the daily volume of foreign exchange market transactions in renminbi has expanded rapidly in the past few years.

Financial Sector Reform

A well-supervised, well-capitalized, and well-managed domestic banking system is important to help ensure that removing controls on capital flows and interest rates is done in a manner that safeguards financial stability. Letting market forces play a greater role in determining interest rates is a crucial component of a more market-based exchange rate regime, as exchange rate movements often reflect differences in interest rates between countries.

- ✓ In April 2005, China announced it would inject \$15 billion of official foreign exchange reserves into the Industrial and Commercial Bank of China (China's largest bank) to shore up its capital. The Ministry of Finance will also provide another \$15 billion as a fiscal injection.
- ✓ In November 2004, China's banking regulator simplified procedures for disposal of non-performing assets of the Chinese banking system by allowing foreign investors (such as U.S. banks) to buy non-performing loans using an improved approval process. This step is viewed as a useful step forward in allowing foreign and domestic investors a consistent and sustainable way to help China's banks resolve these poorly performing assets.
- ✓ In October 2004, China's central bank, in addition to raising one-year deposit and lending rates to slow investment growth and inflation and limit the withdrawal of bank deposits, also eliminated a ceiling on bank lending rates, which will give greater scope to price risk.

- ✓ The banking regulator has adopted a new supervisory strategy. Though implementation is in the early stages, new guidelines outline a comprehensive, risk-based approach that emphasizes adequate governance and internal controls at banks.
- ✓ The regulator unveiled new capital adequacy rules and tightened loan accounting standards by introducing new five-category loan classification guidelines for commercial banks that are more in line with international best practices. While full implementation is not required until 2007, some banks are reporting financial data based on these standards now.
- ✓ China has tightened bank supervision by increasing number and scope of bank audits and on-site bank examinations and setting more aggressive targets for reducing NPLs and increasing capital. The larger banks have also upgraded credit risk management, centralized and standardized credit extension procedures and improved corporate governance. Regulatory moves allow foreign interests to take strategic stakes, clearly define responsibilities for Boards, management and shareholders, and raise disclosure requirements.
- ✓ In December 2003, the government took action to restructure two of the largest state-owned commercial banks by injecting \$45 billion of official reserves as recapitalization funds. The capital injection and June 2004 auction of non-performing loans were aimed at strengthening the balance sheets of two of the largest state-owned banks. In March 2004, the authorities formulated guidelines on corporate governance for the two banks, which include assessing managers' performance based on their attainment of financial benchmarks.
- ✓ In December 2003, China's central bank gave banks greater leeway in determining lending rates.

Foreign Exchange Market and Financial Product Development

Foreign exchange trading systems and financial instruments for managing and hedging foreign exchange risk are critical elements of a market-based flexible exchange rate regime. China is taking steps to encourage foreign and domestic banks to offer foreign exchange services and to develop a foreign exchange derivatives market (for financial products such as futures and forward contracts). Foreign exchange derivatives depend on market participants' ability to borrow and lend in both local and foreign currency, and China is taking further steps to develop its domestic bond markets. Development of local currency bond markets will reduce the risk to firms' balance sheets of currency fluctuations and give the central bank the tools to move away from a monetary policy framework based on a pegged exchange rate towards a framework where market based interest rates play a greater role in achieving price stability.

- ✓ In May 2005, China allowed domestic and foreign banks to trade spot non-renminbi currency pairs (such as dollar-yen) and certain Chinese banks will act as market-makers for this foreign currency trading activity. This follows the signing by China's foreign exchange bureau of an agreement with Reuters last October to provide an on-shore trading network and platform to domestic and foreign banks for spot foreign exchange trading in non-renminbi currency pairs. These measures provide greater liquidity to access foreign exchange in China, and permit China's participating

domestic banks to build trading skills by gaining more experience with trading and settling floating currencies using international foreign exchange trading systems.

- ✓ In May 2005, banks were allowed to trade bond futures, enhancing the ability to hedge interest rate risk.
- ✓ As of December 2004, 24 foreign banks and financial institutions have been authorized to offer foreign exchange derivatives. China's banking regulator will accelerate the approval of applications by foreign banks to open sub-branches, conduct renminbi business, and conduct derivatives business.
- ✓ In August 2004, the Shanghai Futures Exchange (SFE) began cooperation with the New York Mercantile Exchange on physical delivery futures contracts, clearing procedures and risk management (including comprehensive training). Fuel oil futures will be initiated by SFE. This step will help deepen knowledge of derivatives instruments in general and how to trade, process and clear these types of financial transactions in China.
- ✓ In June 2004, China's foreign exchange operational center in Shanghai initiated a collaborative effort with the Chicago Mercantile Exchange to develop new products to hedge foreign exchange risk using derivatives (such as currency and interest rate futures contracts).
- ✓ In June 2004, China's banking regulator permitted foreign banks to offer foreign currency financial products to local and foreign businesses.
- ✓ In February 2004, the Ministry of Finance announced expansion of the maturity structure of its benchmark yield curve by adding two points for two- and five-year treasury bonds. This is a movement toward greater market-determined domestic interest rates and will assist in creating a benchmark interest rate yield curve needed, among other things, to price forward contracts.
- ✓ In November 2003, China announced plans to allow renminbi trading and deposits in Hong Kong.

Financial Services and Capital Markets Opening

Opening the Chinese banking sector further should encourage competition in financial (including foreign exchange) services. Foreign financial institutions also bring in state of the art expertise in managing foreign exchange risk.

- ✓ As of December 2004, China permitted five foreign non-bank auto finance companies to extend auto loans. GMAC and its Chinese partner's joint venture have started financing operations. Ford Motor's financial unit also was approved to set up operations. The other companies include Toyota, Volkswagen and Daimler-Chrysler.
- ✓ As of December 2004, 61 foreign banks and financial institutions are approved to provide renminbi products and services to Chinese companies. China has approved qualified foreign banks to enter the money markets to conduct inter-bank lending operations. Geographic restrictions have been lifted on foreign banks conducting renminbi business in five large provinces.
- ✓ As of December 2004, 27 foreign institutions have obtained a license to invest in Chinese domestic capital markets as part of the Qualified Foreign Institutional Investor (QFII) program.

- ✓ In mid-2004, U.S. investment bank Goldman Sachs received approval to form and control a joint venture securities firm in China, the first and only one of its kind.
- ✓ In September 2004, China streamlined the application process for foreign banks regarding new entry or expansion of business, and incorporated prudential rule changes to ensure national treatment.
- ✓ Over the past year, China has lowered capital requirements for bank branches. In September 2004, China permitted foreign banks to open multiple bank branches each year (rather than just one).
- ✓ In December 2003, China's bank regulator announced modest measures to allow foreign banks more local currency business and larger stakes in joint venture banks.

Trade Transaction Reform

- ✓ In July 2004, the United States and China reached an agreement to resolve a WTO dispute regarding China's tax refund policy for integrated circuits, a market worth \$2 billion to American manufacturers and workers. The resolution will ensure non-discriminatory tax treatment for U.S. integrated circuits in China, the world's fastest growing semiconductor market.
- ✓ In January 2004, China approved plans to reform its export tax rebate system by adjusting rebate rates on certain exports. This step helps to reduce the tax incentives to exporters.

